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August 11, 2017

Brent Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609
Via email to *rule-comments@sec.gov*

Re: IA-BD-Conduct-Standards
In Response to Chairman Clayton's Request for Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers

Dear Mr. Fields:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules which govern the conduct of those who provide advice to investors.

On June 1, 2017, Chairman Clayton issued a Public Statement, seeking comment on a number of questions regarding broker and investment adviser standards of conduct.[1] PIABA welcomes this opportunity to comment, as it has commented on the prior SEC requests on this topic.[2] PIABA hopes that the SEC moves forward with a uniform fiduciary standard for brokers and investment advisers, as permitted by Dodd-Frank.[3]

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[1] Chairman Jay Clayton, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers* (June 1, 2017), available at https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31.

[2] PIABA, *Comment Letter to the SEC on Study Regarding Obligations of Brokers, Dealers, and Investment Advisers* (Sept. 3, 2010), available at https://piaba.org/piaba-newsroom/piaba-comment-letter-study-regarding-obligations-brokers-dealers-and-investment-advis; PIABA, *Comment Letter to the SEC on Duties of Brokers, Dealers, and Investment Advisers* (July 3, 2013), available at https://piaba.org/piaba-newsroom/piaba-comment-letter-duties-brokers-dealers-and-investment-advisers-july-3-2013.

[3] The Dodd–Frank Wall Street Reform and Consumer Protection Act, § 913, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

PIABA will address certain of the questions raised by Chairman Clayton.

Question: *Retail investors have expressed confusion about the type of professional or firm that is providing them with investment advice, and the standards of conduct applicable to different types of relationships. To what extent has this reported confusion been addressed? If meaningful confusion remains, is the confusion harming retail investors or resulting in other costs? If so, what steps should be taken to address this situation? What disclosures, advertising, or other information do investment advisers and broker-dealers provide to retail investors currently, and how do those contribute to or mitigate any investor confusion? Are there specific disclosure requirements or other steps the Commission should consider to address any confusion regarding applicable standards?*

There is one thing about which there can be no confusion: investors do not understand the factors distinguishing investment advisors from brokerage firms. This problem is exacerbated by the industry's continued marketing efforts that serve to mislead the investing public.

There have been a number of studies conducted that confirm that investors are confused about the duties they are owed and with whom they are doing business. In its original report to Congress, the "Study on Investment Advisers and Broker-Dealers" (the "SEC Study"),[4] the SEC studied the extent to which retail customers were confused about the status of the person from whom they receive financial services. The SEC reviewed two studies which it sponsored (the "Seigel & Gale Study" and the "RAND Report"), and a study conducted by Consumer Federation of America (the "CFA Survey").

The SEC Study found that, based on the comments, studies and surveys it had reviewed, investors did not understand the differences between investment advisers and broker-dealers. The SEC determined that this misunderstanding is compounded by the fact that many retail investors may not have the "sophistication, information, or access needed to represent themselves effectively in today's market and to pursue their financial goals."[5] The SEC Study concluded that, "it is important that retail investors be protected uniformly when receiving personalized investment advice or recommendations about securities regardless of whether they choose to work with an investment adviser or a broker-dealer. It is also important that the personalized securities advice to retail investors be given in their best interests, without regard to the financial or other interest of the financial professional, in accordance with a fiduciary standard."[6]

The Seigel & Gale Study utilized focus groups to examine how investors differentiate the roles, legal obligations, and compensation between investment advisers and broker-dealers.[7] The focus group participants did not understand that there were differing roles and legal obligations

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[4] SEC, *Study on Investment Advisers and Broker-Dealers* ("SEC Study") (Jan. 2011), available at http://www.sec.gov/news/studies/2011/913studyfinal.pdf.
[5] *See id.* at 101.
[6] *See id.* at 101.
[7] *See id.* at 95.

between investment advisers and brokers. The participants were also confused by the different titles used within the industry, and did not understand terms such as "fiduciary."[8]

In 2006, the SEC commissioned RAND to study whether investors understood the obligations of brokers and investment advisers.[9] RAND examined the business practices of brokers and investment advisers, and conducted an investor survey.[10] Because of the complex affiliations and relationships between firms offering different services, RAND had difficulty determining with certainty the brokers' and investment advisers' respective business practices.[11] RAND also noted that it could be difficult for investors to understand the differences in the services provided by the firms because of the lack of uniformity in how information was presented.[12] Through its interviews of brokers and investment advisers, RAND learned that the firms believed investors will trust them without necessarily understanding their services and responsibilities.[13] Through its investor survey, RAND learned that investors did not understand the differences between brokers and investment advisers, and found their titles confusing.[14] Survey participants noted that "the interchangeable titles and 'we do it all' advertisements made it difficult to discern" brokers from investment advisers.[15] Investors believed that their financial professional was acting in their best interest.[16]

The CFA Survey was conducted in 2010 on behalf of Consumer Federation of America (CFA), AARP, the Investment Adviser Association, the Financial Planning Association, the CFP Board, the North American Securities Administrators Association (NASAA), and the National Association of Personal Financial Advisors.[17] The CFA Survey found that a majority of investors believe a broker is held to a fiduciary standard.[18]

More recent studies have been conducted following the issuance of the SEC Report, confirming the same information the SEC reported. For example, a 2015 study confirmed that most retail customers think their financial advisor – regardless of which type of advisor it is – is a fiduciary.[19] Further, the industry is aware of the confusion. In a survey open to all brokers, investment advisers, and insurance consultants and producers, 97 percent of them said "investors don't understand the differences between brokers and investment advisers."[20]

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[8] *See id.* at 96.
[9] *See id.*
[10] *See id.*
[11] *See id.* at 97.
[12] *See id.*
[13] *See id.*
[14] *See id.* at 98.
[15] *Id.*
[16] *See id.*
[17] *See* infogroup/ORC, *U.S. Investors & The Fiduciary Standard: A National Opinion Survey* (Sept. 15, 2010), available at https://www.cfp.net/docs/public-policy/us_investors_opinion_survey_2010-09-16.pdf?sfvrsn=2.
[18] *See* SEC Study, *supra* note 4 at 100.
[19] *See* Spectrem Group, *Fiduciary – Do Investors Know What It Means* (2015), available at http://spectrem.com/Content_Whitepaper/fiduciary.aspx.
[20] *See* fi360-ThinkAdvisor, *Trustworthy Advice and Individual Investors: Will Regulators Act in Investors' Best Interest?* (Aug. 2013), available at http://www.fi360.com/uploads/media/fiduciarysurvey_resultsreport_2013.pdf; *see also* fi360-ThinkAdvisor, *Seeking Trustworthy Advice for Individual Investors – Financial Intermediaries*

As demonstrated by the Seigel & Gale Study and the RAND Report, investors' confusion between brokers and investment advisers is aggravated by the industry's confusing use of titles. The individuals working for the firms are bestowed with impressive titles such as "Financial Advisor," "Financial Consultant," "Retirement Consultant," and "Wealth Manager."[21] Brokers are never called brokers.

Investors are also confused by firm advertising. In a study conducted by PIABA in 2015, PIABA examined the websites of nine different brokerage firms (the "PIABA Report").[22] PIABA examined Allstate, UBS, Morgan Stanley, Berthel Fisher, Ameriprise, Merrill Lynch, Fidelity, Wells Fargo, and Charles Schwab and found that the firms' advertising presents the image that the firms are acting in a fiduciary capacity.[23]

The following are examples of the advertising included in the PIABA Report:

UBS:
Until my client knows she comes first. Until I understand what drives her. And what slows her down. Until I know what makes her leap out of bed in the morning. And what keeps her awake at night. Until she understands that I'm always thinking about her investment. (Even if she isn't.) Not at the office. But at the opera. At a barbecue. In a traffic jam. Until her ambitions feel like my ambitions. Until then. We will not rest. UBS.[24]

Morgan Stanley:
Having an intimate knowledge of blue chips and small caps is important. But even more important is an intimate knowledge of you and your goals. Get connected to a Morgan Stanley Financial Advisor and get a more personalized plan for achieving success.[25]

Ameriprise:
Focus on your dreams and goals
Once you've identified your dreams and goals, and you and the advisor have decided to work together, you can count on sound recommendations that address your goals. You'll be able to clearly see and discuss how the actions and decisions you make today will affect your tomorrow. You can expect to hear about the options you have and any underlying factors to consider. Our advisors are ethically obligated to act with your best interests at heart.

Indicate Strong Support for Fiduciary Standard (Feb. 2015), available at http://www.fi360.com/uploads/media/2015fiduciarysurvey.pdf.

[21] *See* Consumer Federation of America & Americans for Financial Reform, *Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have it Both Ways*, 5-6 (Jan. 18, 2017) ("CFA/AFR Report"), available at http://ourfinancialsecurity.org/wp-content/uploads/2017/01/Financial-Advisor-or-Investment-Salesperson.pdf.

[22] *See* PIABA, *Major Investor Losses due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of a Fiduciary Duty; Misleading Ads Fuel Confusion, Underscore Need for Fiduciary Standard* (Mar. 25, 2015) (the "PIABA Study"), available at https://piaba.org/system/files/pdfs/PIABA%20Conflicted%20Advice%20Report.pdf.

[23] *See id.* at 1.

[24] *Id.* at 9.

[25] *Id.* at 10.

Personalized advice and recommendations on an ongoing basis
Perhaps the best thing about working with a personal financial advisor is that your financial plan is custom made for you. The financial advisor you choose to work with knows all about you. When and if you experience a life change, your priorities shift or you have a pressing financial question, you can contact your advisor for information and financial advice that's meaningful to you. You may meet a few times during a year and have several discussions. Your advisor will make every effort to be available to you when needed.[26]

Wells Fargo:
Are we working toward common goals?
A healthy relationship with your Financial Advisor should make you feel that your best interests are the top priority, no matter what is happening in the market and no matter the size of your portfolio. Furthermore, you should like your advisor, and both you and your advisor should feel that all concerns are heard and addressed.
Are we sharing information and asking questions?
Your financial consultant should provide you with the relevant information needed to help you feel informed about financial events that pertain to your investments. Your Financial Advisor may also answer any questions you might have about your monthly statements. Stay in contact to ensure that your advisor is current on your objectives and can make changes when necessary.[27]

Charles Schwab:
For many years, we've encouraged investors like you to "Talk to Chuck" so we could help you manage through the array of investing challenges and opportunities. I still encourage you to do that. We'll share with you our passion for investing and our thoughts on how to do it well, and we'll listen to you to understand how we can help you reach your goals. But going forward, you'll be hearing more about the values we stand for and why they might matter to you. Our communications will emphasize the fundamental belief we share with you: a belief that through personal engagement and a relationship of mutual respect, your financial goals and a better tomorrow are within reach.
Does my broker discuss the risks in my investment portfolio?
All investors need to understand the various risks in their investment portfolio and their tolerance level for those risks. But, how much and how often do you discuss these risks with your broker? Is your broker proactive about communicating possible risks as things change in the markets, economy or in your personal situation?[28]

In January 2017, almost two years later, Consumer Federation of America and Americans for Financial Reform looked at these same firms (the "CFA/AFR Report").[29]

UBS:
On the firm's homepage, a rotating banner reads: "Advice. Beyond investing." A prospective client who navigates to the firm's Investing webpage will see the following statement:

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[26] *Id.* at 11.
[27] *Id.* at 14.
[28] *Id.* at 15.
[29] *See* CFA/AFR Report, *supra* note 21.

"Building an investment plan and an optimal asset allocation strategy to meet your unique needs requires careful consideration and often, outside expertise. Our UBS Financial Advisors are committed to helping you with this process, allowing you to spend more time on the activities you truly enjoy...UBS Financial Advisors take a holistic wealth management approach to carefully understanding your overall financial situation, unique needs and goals, and deliver an optimal investment solution to meet them."[30]

Morgan Stanley:
The firm's "Wealth Management" webpage states: "You have meaningful goals. Our Financial Advisors can help you reach them. For nearly 80 years, we have worked with individuals, families, businesses, and institutions—to deliver services and solutions that help build, preserve and manage wealth. We understand our clients' aspirations, and we're as devoted to their goals as they are." The webpage further states: "The Path to Reaching Your Goals Begins with a Financial Advisor: Morgan Stanley Financial Advisors harness the firm's global resources and intellectual capital to help create a financial strategy that works for you."[31]

Ameriprise:
The website features a 44-page "Client Relationship Guide" whose stated purpose is to give clients a better understanding of the company and the services it offers. It states: "Our commitment to you: We provide personal, high-quality advice. Our approach is based on sound financial principles and a full view of your needs. We go beyond the numbers to understand your needs and provide you with clear actions you can take to help you achieve your dreams and feel more confident about the future. We tailor our advice to your personal objectives, time horizon, and risk tolerance, as well as other factors."[32]

Wells Fargo:
The center of the Wells Fargo homepage features the statement: "Helping Clients Succeed Financially. We provide advice and guidance to help maximize all elements of your financial life, whenever and however you need it." A prospective client who clicks on the "Why Invest With Us" tab will find the following statement under the "Our Advisors" heading: "A Financial Advisor can provide the advice and guidance you need to focus on your short- and long-term goals while navigating life's financial opportunities and turning points. Start planning now for the future. Choose a Financial Advisor from the firm that lives and breathes a client-centered approach to advice."[33]

Charles Schwab:
The homepage of the firm's website features the question: "How will you help me with my financial goals?" The answer, in big, bold font: "A Schwab Financial Consultant can help you create a plan tailored to your needs." It continues: "It starts with a conversation and a fresh perspective, discussing your long- and short-term goals. We evaluate your current investments then create specific recommendations." The website describes the benefits of

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[30] *Id*. at 9.
[31] *Id*.
[32] *Id*. at 8.
[33] *Id*.

meeting with a financial consultant this way: "Your Financial Consultant can work with you to create a holistic plan with specific investment recommendations and a clear explanation of the benefits and risks....Your plan will reflect your priorities, from retirement income and estate planning to insurance and debt management. And you can meet regularly to keep your plan up to date as your life evolves.[34]

Very little changed between the time the PIABA Report and the CFA/AFR Report were issued. Firms continue to present themselves as providing all-encompassing advice, with no differentiation between the firms' investment adviser services and brokerage services. Investors remain confused by this ambiguous advertising. Simply correcting the advertising at this point will not be able to remedy the misunderstandings pervasive throughout the investing public. Further, as the RAND Report pointed out, investors will trust brokers and investment advisers without understanding the scope of the services they offer. The confusion regarding brokers and investment advisers is so deeply ingrained, investors are left with the impression that both are obligated to act in their best interests. At this point, the best way to address investor confusion will be to hold both brokers and investment advisers to a fiduciary duty.

Question: *Have potential conflicts of interest related to the provision of investment advice to retail investors in various circumstances been appropriately identified and, if so, have they been appropriately addressed? Are there particular areas where conflicts are more prevalent, have greater potential for harm, or both? To what extent are retail investors being, or expected to be, harmed by these conflicts currently and in the future? For example, do certain types of relationships result in systematically lower net returns or greater degrees of risk in retail investors' portfolios relative to other similarly-situated investors in different relationships? Are there steps the Commission should take to identify and address these conflicts? Can they be appropriately addressed through disclosure or other means? How would any such steps to address potential conflicts of interest benefit retail investors currently and over time? What costs or other consequences, if any, would retail investors experience as a result of any such steps? For example, would broker-dealers or investment advisers be expected to withdraw from or limit their offerings or services in certain markets or products?*

The current rules governing brokers and investment advisers do not provide adequate protections for retirement investors. FINRA Rule 2111, (the "Suitability Rule"), governing brokers, requires that a broker only have a "reasonable basis" for making an investment recommendation, and that the recommendation be "suitable" for the investor. Under this suitability standard, a broker may sell a mutual fund with high expenses rather than a functionally identical fund, which may cost the investor less but pay the broker less. These conflicts are not adequately managed by the current rules.

The following enforcement actions demonstrate that the prevailing culture within the industry is to place the financial interests of the firms above the interests of the investors. Firms overcharge investors, recommend higher fee share classes, recommend replacements of existing mutual funds and annuities, and recommend complex products with opaque fee structures. This conduct

[34] *Id.* at 7.

is not limited to one sector of the brokerage industry – it occurs in firms both large and small. Note further that the violations carry across the broad spectrum of investment types.

Mutual Funds:

FINRA "fined Oppenheimer & Co. Inc. $2.25 million and ordered the firm to pay restitution of more than $716,000 to affected customers for selling leveraged, inverse and inverse-leveraged exchange-traded funds (non-traditional ETFs) to retail customers without reasonable supervision, and for recommending non-traditional ETFs that were not suitable."[35]

FINRA "ordered Barclays Capital, Inc. to pay more than $10 million in restitution, including interest, to affected customers for mutual fund-related suitability violations. These suitability violations relate to an array of mutual fund transactions including mutual fund switches. Additionally, the firm failed to provide applicable breakpoint discounts to certain customers. Barclays was also censured and fined $3.75 million."[36]

FINRA "ordered five firms to pay restitution estimated at more than $18 million, including interest, to affected customers for failing to waive mutual fund sales charges for eligible charitable organizations and retirement accounts."[37]

FINRA "ordered 12 firms to pay restitution totaling more than $4 million and fines totaling more than $2.6 million for failing to apply available sales charge discounts to customers' purchases of Unit Investment Trusts (UITs), and related supervisory failures."[38]

FINRA "ordered Wells Fargo Advisors, LLC, Wells Fargo Advisors Financial Network, LLC, Raymond James & Associates, Inc., Raymond James Financial Services, Inc. and LPL Financial LLC to pay more than $30 million in restitution, including interest, to affected customers for failing to waive mutual fund sales charges for certain charitable and retirement accounts."[39]

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[35] FINRA Press Release, *FINRA Sanctions Oppenheimer & Co. $2.9 Million for Unsuitable Sales of Non-Traditional ETFs and Related Supervisory Failures* (June 8, 2016), available at http://www.finra.org/newsroom/2016/finra-sanctions-oppenheimer-co-29-million-unsuitable-sales-non-traditional-etfs.
[36] FINRA Press Release, *FINRA Sanctions Barclays Capital, Inc. $13.75 Million for Unsuitable Mutual Fund Transactions and Related Supervisory Failures* (Dec. 29, 2015), available at http://www.finra.org/newsroom/2015/finra-sanctions-barclays-capital-inc-1375-million-unsuitable-mutual-fund-transactions.
[37] FINRA Press Release, *FINRA Orders an Additional Five Firms to Pay $18 Million in Restitution to Charities and Retirement Accounts Overcharged for Mutual Funds* (Oct. 27, 2015), available at http://www.finra.org/newsroom/2015/finra-orders-5-firms-pay-18-million-failing-waive-fund-sales-charges.
[38] FINRA Press Release, *FINRA Sanctions 12 Firms a Total of $6.7 Million for Failing to Apply Sales Charge Discounts to Customers' Purchases of UITs* (Oct. 20, 2015), available at http://www.finra.org/newsroom/2015/finra-sanctions-12-firms-67-million-failing-apply-sales-charge-discounts-uits.
[39] FINRA Press Release, *FINRA Orders Wells Fargo, Raymond James, and LPL Financial to Pay More Than $30 Million in Restitution to Retirement Accounts and Charities Overcharged for Mutual Funds* (July 6, 2015), available at http://www.finra.org/newsroom/2015/finra-sanctions-wells-fargo-raymond-james-and-lpl-30-million.

Variable Annuities:

FINRA "fined Houston-based VALIC Financial Advisors, Inc. (VFA), a total of $1.75 million for failing to identify and reasonably address certain conflicts of interest in the firm's compensation policy for instances when customers elected to move assets out of their VALIC variable annuities (VA), many of which were held in retirement plan accounts. The firm also failed to adequately supervise its VA business, including the sale of VAs with multiple share classes."[40]

FINRA "fined eight firms, including VOYA Financial Advisors, five broker-dealer subsidiaries of Cetera Financial Group, Kestra Investment Services, LLC, and FTB Advisors, Inc., a total of $6.2 million for failing to supervise sales of variable annuities (VAs). FINRA also ordered five of the firms to pay more than $6 million to customers who purchased L-share variable annuities with potentially incompatible, complex and expensive long-term minimum-income and withdrawal riders."[41]

FINRA "fined MetLife Securities, Inc. (MSI) $20 million and ordered it to pay $5 million to customers for making negligent material misrepresentations and omissions on variable annuity (VA) replacement applications for tens of thousands of customers. Each misrepresentation and omission made the replacement appear more beneficial to the customer, even though the recommended VAs were typically more expensive than customers' existing VAs. MSI's VA replacement business constituted a substantial portion of its business, generating at least $152 million in gross dealer commission for the firm over a six-year period."[42]

Puerto Rican securities:

FINRA "ordered Santander Securities LLC to pay approximately $4.3 million in restitution to certain customers who were solicited to purchase Puerto Rican Municipal Bonds (PRMBs). Additionally, the firm will pay restitution of $121,000 and make offers of rescission to buy back the securities sold to certain customers impacted by the firm's failure to supervise employee trading. FINRA also censured and fined Santander $2 million for supervisory failures related to sales of PRMBs and Puerto Rican closed-end funds, and for failing to reasonably supervise employee trading in its Puerto Rico branch office."[43]

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[40] FINRA Press Release, *FINRA Fines VALIC Financial Advisors, Inc. $1.75 Million for Failure to Prevent Conflicts of Interest in its Compensation Policy and for Other Supervisory Failures Related to Variable Annuity Sales* (Nov. 28, 2016), available at http://www.finra.org/newsroom/2016/finra-fines-valic-financial-advisors-inc-175-million-failure-prevent-conflicts.

[41] FINRA Press Release, *FINRA Fines Eight Firms a Total of $6.2 Million for Supervisory Failures Related to Variable Annuity L-Shares* (Nov. 2, 2016), available at http://www.finra.org/newsroom/2016/finra-fines-eight-firms-total-62-million-supervisory-failures-related-variable-annuity.

[42] FINRA Press Release, *FINRA Sanctions MetLife Securities, Inc. $25 Million for Negligent Misrepresentations and Omissions in Connection With Variable Annuity Replacements* (May 3, 2016), available at http://www.finra.org/newsroom/2016/finra-sanctions-metlife-securities-inc-25-million-negligent-misrepresentations-and.

[43] FINRA Press Release, *FINRA Sanctions Santander Securities LLC $6.4 Million for Supervisory Failures Related to Sales of Puerto Rican Bonds* (Oct. 13, 2015), available at http://www.finra.org/newsroom/2015/finra-sanctions-santander-64-million-pr-bond-supervisory-failures.

FINRA "censured and fined UBS Financial Services Incorporated of Puerto Rico (UBS PR) $7.5 million for supervisory failures related to the suitability of transactions in Puerto Rican closed-end fund (CEF) shares. In addition, FINRA ordered UBS PR to pay approximately $11 million in restitution to 165 customers who were forced to realize losses on their CEF positions."[44]

Other Complex Products:

FINRA "announced . . . that Albany, New York-based Purshe Kaplan Sterling Investments (PKS) will pay nearly $3.4 million in restitution to a Native American tribe, after the tribe paid excessive sales charges on purchases of non-traded Real Estate Investment Trusts (REITs) and Business Development Companies (BDCs). In addition to ordering restitution, FINRA fined PKS $750,000 for its failures to supervise the sales of these securities."[45]

FINRA "fined Merrill Lynch, Pierce, Fenner & Smith, Inc. $5 million for negligent disclosure failures in connection with the sale of five-year senior debt notes to retail customers. In particular, Merrill Lynch failed to adequately disclose certain costs, making it appear that the fixed costs were lower than they actually were."[46]

FINRA "censured LPL Financial LLC and fined it $10 million for broad supervisory failures in a number of key areas, including the sales of non-traditional exchange-traded funds (ETFs), certain variable annuity contracts, non-traded real estate investment trusts (REITs) and other complex products, as well as its failure to monitor and report trades and deliver to customers more than 14 million trade confirmations. In addition to the fine, FINRA ordered LPL to pay approximately $1.7 million in restitution to certain customers who purchased non-traditional ETFs. The firm may pay additional compensation to ETF purchasers pending a review of its ETF systems and procedures."[47]

FINRA "ordered RBC Capital Markets to pay a $1 million fine and approximately $434,000 in restitution to customers for supervisory failures resulting in sales of unsuitable reverse convertibles."[48]

FINRA "fined Merrill Lynch, Pierce, Fenner & Smith Incorporated $1.9 million for fair pricing and supervisory violations in connection with more than 700 retail customer transactions in

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[44] FINRA Press Release, *FINRA Sanctions UBS Puerto Rico $18.5 Million for Supervisory Failures Regarding Sales of Puerto Rican Closed-End Funds and Related Loans* (Sept. 29, 2015), available at http://www.finra.org/newsroom/2015/finra-sanctions-ubs-puerto-rico-185-million-supervisory-failures.

[45] FINRA Press Release, *FINRA Orders Purshe Kaplan Sterling Investments to Pay $3.4 Million in Restitution to Native American Tribe; Firm Also Fined $750,000 for Failures to Supervise* (Feb. 22, 2017), available at http://www.finra.org/newsroom/2017/finra-orders-purshe-kaplan-sterling-pay-34-million-native-american-tribe.

[46] FINRA Press Release, *FINRA Fines Merrill Lynch $5 Million for Failing to Disclose Material Facts in Sales of Volatility-Linked Structured Notes to Retail Customers* (June 23, 2016), available at http://www.finra.org/newsroom/2016/finra-fines-merrill-lynch-5-million-related-return-notes-sales.

[47] FINRA Press Release, *FINRA Sanctions LPL Financial LLC $11.7 Million for Widespread Supervisory Failures Related to Complex Products Sales, Trade Surveillance and Trade Confirmations Delivery* (May 6, 2015), available at http://www.finra.org/newsroom/2015/finra-sanctions-lpl-117-million-widespread-supervisory-failures.

[48] FINRA Press Release, *FINRA Orders RBC to Pay Fine and Restitution Totaling More Than $1.4 Million for Unsuitable Sales of Reverse Convertibles* (Apr. 23, 2015), available at http://www.finra.org/newsroom/2015/finra-orders-rbc-pay-fine-and-restitution-totaling-more-14-million.

distressed securities over a two-year time period. Merrill Lynch was also ordered to pay more than $540,000 in restitution, plus interest, to affected customers."[49]

FINRA "fined Citigroup Global Markets Inc. $1.85 million for failing to provide best execution in approximately 22,000 customer transactions involving non-convertible preferred securities, and for related supervisory deficiencies for more than three years. FINRA also ordered Citigroup to pay more than $638,000 in restitution, plus interest, to affected customers."[50]

FINRA "fined LPL Financial LLC $950,000 for supervisory deficiencies related to the sales of alternative investment products, including non-traded real estate investment trusts (REITs), oil and gas partnerships, business development companies (BDCs), hedge funds, managed futures and other illiquid pass-through investments."[51]

FINRA "fined Berthel Fisher & Company Financial Services, Inc. and its affiliate, Securities Management & Research, Inc., of Marion, Iowa, a combined $775,000 for supervisory deficiencies, including Berthel Fisher's failure to supervise the sale of non-traded real estate investment trusts (REITs), and leveraged and inverse exchange-traded funds (ETFs)."[52]

Firms struggle to ensure their suitability obligations are not overshadowed by the firm's own interests. Obviously, there is a cultural problem whereby the Suitability Rule, standing on its own, is not sufficient to provide investors with adequate protection. FINRA enforcement decisions and guidance have made clear that "a broker's recommendations must be consistent with his customers' best interests."[53] However, FINRA itself has recognized that a central failing it has observed is a firm not putting customers' interests first.[54] This is a significant issue. "The harm caused by this may be compounded when it involves vulnerable investors (e.g., senior investors) or a major liquidity or wealth event in an investor's life (e.g., an inheritance or Individual Retirement Account rollover). Poor advice and investments in these situations can have especially devastating and lasting consequences for the investor."[55]

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[49] FINRA Press Release, *FINRA Fines Merrill Lynch $1.9 Million and Orders Restitutin of $540,000 for Fair Pricing and Supervisory Violations Related to Purchases of Distressed Securities* (Dec. 16, 2014), available at http://www.finra.org/newsroom/2014/finra-fines-merrill-lynch-19-million-and-orders-restitution-540000-fair-pricing.
[50] FINRA Press Release, *FINRA Fines Citigroup Global Markets Inc. $1.85 Million and Orders Restitution of $638,000 for Best Execution and Supervisory Violations in Non-Convertible Preferred Securities Transactions* (Aug. 26, 2014), available at http://www.finra.org/newsroom/2014/finra-fines-citigroup-global-markets-inc-185-million-and-orders-restitution-638000.
[51] FINRA Press Release, *FINRA Fines LPL Financial LLC $950,000 for Supervisory Failures Related to Sales of Alternative Investments* (Mar. 24, 2014), available at http://www.finra.org/newsroom/2014/finra-fines-lpl-financial-llc-950000-supervisory-failures-related-sales-alternative.
[52] FINRA Press Release, *FINRA Fines Berthel Fisher and Affiliate, Securities Management & Research, $775,000 for Supervisory Failures Related to Sales of Non-Traded REITs and Leveraged and Inverse ETFs* (Feb. 24, 2014), available at http://www.finra.org/newsroom/2014/finra-fines-berthel-fisher-and-affiliate-securities-management-research-775000.
[53] *See* James S. Wrona, *The Best of Both Worlds: A Fact-Based Analysis of the Legal Obligations of Investment Advisers and Broker-Dealers and A Framework for Enhanced Investor Protection*, 68 Bus. Law. 1, 19, n. 137 (2012) (collecting sources).
[54] FINRA 2015 Regulatory and Examination Priorities Letter (2015), available at http://www.finra.org/industry/2015-exam-priorities-letter.
[55] *Id.*

The principal reason the Suitability Rule fails to ensure investors' interests come first is derived from the issues inherent in the compensation practices within the industry. PIABA's concern regarding improper compensation incentives is not novel. It has been recognized for some time that the compensation structure of the brokerage industry has the potential to harm investors. In 1995, the SEC released the Report of the Committee on Compensation Practices (the "Tully Report"), which recognized that paying brokers compensation that differed based on the product sold raised questions as to whether a broker rendered "objective advice or simply maximize[ed] commission income."[56] For example, a broker may choose to recommend B share mutual funds to a client, instead of lower cost A shares because the broker is paid more when B shares are sold.[57] Brokers may also recommend transactions for the primary purpose of generating commissions for the broker.[58] Research has demonstrated that when investors purchase mutual funds through brokers, they pay more for the advice because of conflicts of interest.[59] There is evidence that brokers do not effectively manage these conflicts, and end up giving unfairly biased investment advice.[60]

In 2013, FINRA echoed the Tully Report's concerns when it released a report on conflicts of interest, praising brokerage firm efforts to mitigate the financial incentive to recommend one product over another.[61] However, conflicts persist and continue to harm investors. As demonstrated by the enforcement actions highlighted above, firms continue to offer unfairly biased advice.

Firms and brokers must be held to a higher standard than that imposed by the Suitability Rule so the culture of self-interest within the industry is replaced with one of well-earned trust and confidence. While FINRA endeavors to treat the Suitability Rule as a best interest conduct standard, the rule itself is silent as to the firms' management of conflicts of interest. Brokers are told to recommend appropriate investments, they are not explicitly told that to do so, they must

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[56] SEC Committee on Compensation Practices, *Report on Broker-Dealer Compensation* (April 10, 1995) ("Tully Report"), available at https://www.sec.gov/news/studies/bkrcomp.txt.
[57] *See e.g., In Re Belden,* SEC Release No. 47859, 2003 WL 21088079 (May 14, 2003)("As a result of Book's purchase of Class B shares, Belden received significantly greater commissions than he would have received had Book purchased the Class A shares. Indeed, as Belden testified, this is the precise reason that he recommended the Class B shares instead of the Class A shares. In short, Belden put his own interest before that of his customer.").
[58] *See e.g., In the Matter of the Application of Scott Epstein for Review of Disciplinary Action Taken by Finra*, SEC Release No. 59328, 2009 WL 223611 (Jan. 30, 2009)("The record shows that Epstein's mutual fund switch recommendations served his own interest by generating substantial production credits, but did not serve the interests of his customers. Epstein abdicated his responsibility for fair dealing when he put his own self-interest ahead of the interests of his customers.").
[59] *See* Donald C. Langevoort, *Brokers As Fiduciaries,* 71 U. Pitt. L. Rev. 439, 448 (2009) ("There is evidence that investors pay significantly more for mutual fund investments sold via the broker channel, without receiving any better fund performance. The conflicts of interest here are clear enough-brokers are tempted to push high load shares, shares of funds that pay for "shelf space" (i.e., featured presence in brokers' recommendations) or of proprietary funds sponsored by the broker's firm, which are naturally more profitable for the firm."). *See also* White House Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings* 10-14 (Feb. 2015) ("CEA Report"); available at https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf.
[60] *See* CEA Report, supra note 59.
[61] FINRA, Report on Conflicts of Interest 26–30 (Oct. 2013) ("FINRA Conflicts Report"), *http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p359971.pdf*.

put their customer's interests ahead of their own and eliminate, to the extent possible, conflicts which may lead to unfairly biased advice. Brokers must be obligated to act in the best interests of the investor, which means placing investors' interests above their own and appropriately eliminating or at least managing the conflicts of interest that are pervasive throughout the industry. The Suitability Rule is not sufficient on its own to remove and manage these conflicts and ensure that brokers have acted in their clients' best interests.

Conflicted advice causes substantial harm to investors. Just looking at retirement savers, SaveOurRetirement.com estimates that investors lose between $57 million and $117 million every day due to conflicted investment advice, amounting to at least $21 billion annually.[62] The Council of Economic Advisers estimate retirement investors are suffering $17 billion in losses annually due to conflicted advice they receive from financial advisors.[63] Something more than the Suitability Rule is needed to ensure that investors are protected, and have an appropriate remedy if a firm or broker fails to adhere to the requisite standards.

Question: *Is there a trend in the provision of retail investment advice toward a fee-based advisory model and away from a commission-based brokerage model? To what extent has any observed trend been driven by retail investor demand, dependability of fee-based income streams, regulations, or other factors? To what extent is any observed trend expected to continue, and what factors are expected to drive the trend in the future? How has any observed trend impacted the availability, quality, or cost of investment advice, as well as the availability, quality, or cost of other investment products and services, for retail investors? Does any such trend raise new risks for retail investors? If so, how should these risks affect the Commission's consideration of potential future action?*

Following the adoption of the Department of Labor's Conflict of Interest Rule (the "DOL Rule"), many thought firms would shift to the fee-based advisory model to avoid the need to comply with the Rule's Best Interest Contract Exemption. However, firms continue to offer a wide variety of options to retirement investors. Many of the large brokerage firms will continue to offer commission-based alternatives for their clients, including Merrill Lynch, Morgan Stanley, Wells Fargo Advisors, LPL Financial, Raymond James, UBS and Edward Jones.[64] Some firms will offer primarily fee-based accounts, but will offer self-directed accounts and the use of robo-advisers for those investors who want to pay transaction based fees.[65] Some firms are tweaking their existing options to ensure compliance with the DOL Rule's requirements, by changing account minimums and fees.[66] Some firms are incorporating the option of robo-advice more

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[62] *See* Save our Retirement, *Comment Letter to the Dep't of Labor* (May 8, 2015), available at http://saveourretirement.com/cms/wp-content/uploads/2015/02/DOL-SOR-Letter-Comment-Period-Request-5-8-15.pdf.
[63] *See* CEA Report, *supra* note 59. "Conflicted advice" refers to advice given on particular investment products where the financial advisor is compensated in fees and commissions that depend on which investment product the customers buys.
[64] Michael Wursthorn, *A Guide to Brokers' Retirement-Account Plans*, Wall Street Journal (May 23, 2017), available at https://www.wsj.com/articles/a-guide-to-brokers-retirement-account-plans-1495558474?tesla=y&mg=prod/accounts-wsj.
[65] E.g., Merrill Lynch and JP Morgan Chase. *See id*.
[66] E.g., Morgan Stanley, Wells Fargo, LPL Financial, Raymond James, and Edward Jones. *See id*.

broadly for retirement accounts.[67] UBS has announced it will shift how it compensates advisors to mitigate conflicts of interest rather than changing what it offers investors.[68]

The vast majority of brokerage firms and financial advisors have stated, without equivocation, that they will continue to offer the full panoply of financial products to small investors, once the DOL Rule goes into effect. For example, Morgan Stanley announced that its transaction based retirement brokerage accounts will continue to offer a broad array of products after the DOL Rule goes into effect, including, but not limited to, mutual funds and exchange traded products.[69] Similarly, Raymond James has announced that it fully expects to continue to offer a full range of investment options for all of its clients once the DOL Rule goes into effect.[70] Likewise, Edward Jones customers who utilize its transaction based IRAs will be able to invest in a full range of stocks, bonds, certificates of deposits, and variable annuities.[71] A recent survey of representatives affiliated with 14 major independent brokerage firms found that 74% of such advisors/brokerage firms have not reduced the number of products that were available to their transaction – based customers as a result of the DOL Rule.[72] These same representatives reported that, while they are acting as fiduciaries, much of their business is still transaction based and therefore available to small investors.[73]

Several brokerage firms have also reduced their fees for small investors and/or account minimums, in response to the DOL Rule. As a result, the DOL Rule has benefitted small investors by providing them with lower fees, and access to services and accounts, which they did not previously have. For example, Merrill Lynch is discounting fees for IRA accounts that are moved over to an advisory relationship in order to equalize the fee level for its low trading brokerage customers.[74] Edward Jones will be reducing the minimum on its fee-based accounts to $25,000 for clients who want to purchase stocks, mutual funds, or exchange traded funds, and to $50,000 for clients who want to purchase individual bonds.[75] In addition, Edward Jones will continue to have a minimum investment requirement of $5,000 for its Guided Solutions Fund Account.[76] Similarly, LPL Financial has announced that it will be reducing the account minimum

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[67] E.g., Wells Fargo, LPL Financial, and Raymond James. *See id.*
[68] Bruce Kelly, *UBS latest to shift broker compensation ahead of DOL fiduciary rule*, Investment News (June 2, 2017), available at http://www.investmentnews.com/article/20170602/FREE/170609979/ubs-latest-to-shift-broker-compensation-ahead-of-dol-fiduciary-rule.
[69] Morgan Stanley Press Release, *Morgan Stanley to Preserve Client Choice for Retirement Accounts* (Oct. 26, 2016), available at https://www.morganstanley.com/press-releases/morgan-stanley-to-preserve-client-choice-for-retirement-accounts.
[70] Andrew Welsch, *Raymond James Follows Morgan's Lead in Keeping Commissions Under Fiduciary Rule*, OnWallStreet.com (Oct. 27, 2016), available at https://www.onwallstreet.com/news/raymond-james-follows-morgans-lead-in-keeping-commissions-under-dol.
[71] Andrew Welsch, *Fiduciary Ready: Edward Jones Unveils Compliance Plans*, OnWallStreet.com (Aug. 19, 2016), available at https://www.onwallstreet.com/news/fiduciary-ready-edward-jones-unveils-compliance-plans.
[72] Diana Britton, *Delay or not IBDs Moving Toward a Fiduciary Future*, WealthManagement.com (Apr. 5, 2017), available at http://www.wealthmanagement.com/industry/delay-or-not-ibds-moving-toward-fiduciary-future.
[73] *Id.*
[74] Greg Iacurci & Christine Idzelis, *Broker-dealer Split on Commissions in Wake of DOL Fiduciary Rule*, Investment News (Oct. 30, 2016), available at http://www.investmentnews.com/article/20161030/FREE/161029902/broker-dealers-split-on-commissions-in-wake-of-dol-fiduciary-rule.
[75] Welsch, *supra* note 71.
[76] *Id.*

for its Optimum Market Portfolios from $15,000 to $10,000, in anticipation of the DOL Rule.[77] Charles Schwab has also recently announced that it plans to launch a new advisory service in the first half of 2017 that will have an investment minimum of $25,000, but will offer comprehensive financial and investment planning, ongoing guidance from planning consultants, and fully automated and diversified portfolios comprised of low-cost, exchange traded funds from Schwab and third-party providers such as Vanguard.[78]

A recent study of representatives affiliated with 14 of the largest independent brokerage firms reflects that 74% of such advisors/firms will continue to allow commission based transactions in retirement accounts after the DOL Rule goes into effect.[79] These representatives reported that they believe that they can operate in the best interest of their clients, while still offering commission based products.[80]

In short, investors continue to have the full range of products and services available to them. Any standards adopted by the SEC should acknowledge that conflicts of interest are pervasive throughout the industry and firms will continue to face challenges when trying to balance the interests of their clients with those conflicts. Any standards adopted should require mitigation of conflicts of interest to the extent possible.

Question: *As of the applicability date of the Fiduciary Rule, there will be different standards of conduct for accounts subject to the Department of Labor's rule and those that are not, as well as existing differences between standards of conduct applicable to broker-dealers and those applicable to investment advisers when providing investment advice. What are the benefits and costs of having multiple standards of conduct?*

Investment advisers and brokers may be held to different standards even when they provide similar personal investment advice to their retail clients. Investment advisers are principally governed by the Investment Advisers Act of 1940 (the "Advisers Act").[81] Under the Advisers Act, an investment adviser owes a fiduciary duty to its clients. This includes an affirmative duty of utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading clients. The Advisers Act represents a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.[82]

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[77] Janet Levaux, *LPL Cuts Prices, Account Minimums Ahead of DOL Fiduciary Rule*, ThinkAdvisor.com (Mar. 16, 2016), available at http://www.thinkadvisor.com/2016/03/16/lpl-cuts-prices-account-minimums-ahead-of-dol-fidu.
[78] Charles Schwab Press Release, *Schwab Announces Schwab Intelligent Advisory* (Dec. 13, 2016), available at http://pressroom.aboutschwab.com/press-release/schwab-investor-services-news/schwab-announces-schwab-intelligent-advisory.
[79] Britton, *supra* note 72.
[80] *Id.*
[81] 15 U.S.C. § 80b-1, *et seq.*
[82] *Sec. Exch. Comm'n v. Capital Gains Research Bureau*, 375 U.S. 180, 192 (1963).

Brokers are governed by the Securities Exchange Act of 1934,[83] and conduct rules promulgated by the Financial Industry Regulatory Authority (FINRA), as well as state statutory and common law. Unlike their investment-adviser counterparts, brokers who provide personalized investment advice are held to the "suitability standard" found in the Suitability Rule if state law does not otherwise impose a fiduciary duty.[84] The suitability standard only requires the broker to "have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile."[85]

Adopted in 2016, the DOL Rule expanded the scope of fiduciary duty for persons who provide financial advice to retirement investors. [86] The DOL has expanded the scope of the fiduciary definition to better protect ERISA plan participants, beneficiaries and IRA owners from "conflicts of interest, imprudence, and disloyalty."[87] The DOL adopted new exemptions, intended to preserve existing business models, including the Best Interest Contract Exemption.[88] However, brokers and investment advisers acting pursuant to the exemption are bound by the "impartial conduct standard."[89] The impartial conduct standard includes giving prudent advice in the investor's best interest, avoiding misleading statements, and charging no more than a reasonable amount.[90]

The lack of a uniform standard of conduct creates a discrepancy between the law and investors' reasonable expectations. As discussed above, investors expect brokers to act as their fiduciary based on the brokerage firms' advertisements that promise the investors disinterested investment advice.[91] Such promises of impartial investment advice create a reasonable expectation of a fiduciary duty,[92] which must be protected under the principles of agency law and contract law. [93] Indeed, as discussed above, empirical studies have shown that investors are likely to believe that brokers are fiduciaries: in one study, more than 60% of the survey participants believed that brokers have a fiduciary duty.[94]

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[83] 15 U.S.C. § 78a, *et seq*.
[84] *See* FINRA Rule 2111.
[85] *Id*.
[86] Dep't of Labor, *Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice; Final Rule*, 81 Fed. Reg. 20,946 (Apr. 8, 2016) ("DOL Final Rule"), available at http://webapps.DOL.gov/FederalRegister/PdfDisplay.aspx?DocId=28806.
[87] *Id*.
[88] *Id*.
[89] *Id*. at 20,947.
[90] *Id*.
[91] *See* Arthur B. Laby, *Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries*, 87 WASH. L. REV. 707, 764-66 (2012) (documenting that brokerage firms have long advertised that they provide personalized advice); *see also* PIABA Study, supra note 22.
[92] Laby, *supra* note 91, at 767–71 (2012) (citing dissenting opinion of *SEC v. Capital Gains Research Bureau, Inc.*, 306 F.2d 606, 617 (2d Cir. 1962) upheld by the U.S. Supreme Court in 375 U.S. 180).
[93] Laby, *supra* note 91, at 760 (2012).
[94] Laby, *supra* note 91, at 751 (2012) (citing the CFA Survey and the RAND Report, *see* discussion of SEC Study, *supra*).

However, the fact remains that the law recognizes that there can be differences in the duties owed by investment advisers and brokers. Brokers may provide advice with significant conflicts of interest present, notwithstanding that the investors believe the broker is acting in their best interests. The courts will often look to the regulatory structure governing the broker rather than the investors' expectations. For example, in *Thomas v. Metropolitan Life Insurance Co*, investors brought a claim under section 80b-6 of the Advisers Act. [95] The investors alleged that the broker with an insurance company who advised the plaintiffs on investing their retirement funds made material omissions concerning the company's conflicts of interest which were created by the company's commission structure, fees, job-retention policies, and other incentives.[96] The court, however, upheld the district court's dismissal of the Advisers Act claim and concluded that the representative was a broker who did not owe a fiduciary duty to the retail investors.[97] The outcome in *Thomas* is typical of the instances where investors suffer from conflicted advice and fail to obtain a judicial remedy.

In a 2015 study, the White House found that costs of conflicted advice are hefty: annual costs for retirement savers of $17 billion.[98] The White House estimates were based on the assumption that there were $1.7 trillion in retirement assets invested in mutual funds and annuities, and had calculated the costs based on the investment into those asset classes.[99] However, it is estimated that approximately $3.3 trillion is invested in IRAs, meaning retirement savers may be losing $33 billion per year if the same assumptions regarding the cost of conflicts are made.[100]

Even the industry agrees that a uniform fiduciary standard for brokers and dealers and its uniform examination are necessary.[101] Maintaining a uniform standard of conduct would lessen the compliance costs for brokerage firms who are also registered as investment advisers. Those savings could be significant, considering the number of dually registered brokerage firms: the SEC found in 2011 that 88% of investment adviser representatives are also registered representatives of broker-dealer firms.[102] The harmonization of standards would allow these dual registrants to save compliance costs that result from working under two sets of regulations.

Without a uniform fiduciary duty, retail investors remain vulnerable to conflicted advice and a legal imbalance in available judicial remedies. Without uniform standards, persons seeking financial advice are left to fend for themselves in deciding whether their financial advisor is serving two masters or only one, and whether one of those masters is the advisor's financial self-interest. Investors are unjustly burdened with the cost from conflicted advice. For this reason,

[95] *Thomas v. Metro. Life Ins. Co.*, 631 F.3d 1153 (10th Cir. 2011).
[96] *Thomas v. Metro. Life Ins. Co.*, No. CIV-07-0121-F, 2008 WL 4619822, at *1 (W.D. Okla. Oct. 16, 2008).
[97] *Thomas*, 631 F.3d at 1166.
[98] CEA Report, *supra* note 59.
[99] *See id.* at 19.
[100] *See id.*
[101] *See Ensuring Appropriate Regulatory Oversight of Broker-Dealers and Legislative Proposals to Improve Investment Adviser Oversight*, Hearings Before the H. Subcomm. on Capital Mkts. and Gov't Sponsored Enters., 112th Cong. 21 (2011) (statement of John Taft, Chairman, The Securities Industry and Financial Markets Association [SIFMA]), available at https://financialservices.house.gov/uploadedfiles/112-58.pdf.
[102] SEC Study, *supra* note 4 at12 (citing letter from Angela C. Goelzer, FINRA, dated Nov. 3, 2010).

consumer advocates have voiced their support to impose a heightened standard of conduct on the brokerage firms and individuals who provide personalized investment advice to investors.[103]

Differences in the standards applicable to brokers and investment advisers, and now, those advising retirement investors, should be eliminated. The SEC should consider adopting a standard no less stringent than that adopted by the DOL.

Question: *If the Commission were to proceed with a disclosure-based approach to potential regulatory action, what should that be? If the Commission were to proceed with a standards-of-conduct-based approach to potential regulatory action, what should that be? Should the standards for investment advisers and broker-dealers be the same or different? Why?*

Disclosure has been the hallmark of the securities industry. However, the effectiveness of disclosure is questionable. For example, studies in the field of behavioral economics have been applied to disclosure issues.[104] There are a number of cognitive biases that may influence investors, including "the hindsight bias, the (flawed) reliance on heuristics (including the availability heuristic), the presence of overconfidence and overoptimism, the endowment effect (and other framing related biases), and the confirmation bias."[105] Other research has argued that "not only may disclosure of conflicts of interest provide no additional protection to beneficiaries, but it may actively encourage both beneficiaries and advisers to ignore the conflicts."[106] Other studies have found the disclosure may lead to more biased advice. For example, if a broker has "just done something upfront and honest (disclosed conflicts of interest), they may tend to unconsciously give themselves moral license to take a little advantage of their customers."[107]

The SEC's own studies of the financial literacy of investors suggest that disclosure is insufficient to protect investors.[108] The SEC's Financial Literacy Study recognized that:

According to the Library of Congress report, studies consistently show that American investors lack basic financial literacy. For example, studies have found that investors do not understand the most elementary financial concepts, such as compound interest and inflation. Moreover, many investors do not understand other key financial concepts, such as diversification or the differences between stocks and bonds, and are not fully aware of investment costs and their impact on investment returns. According to the Library of Congress report, studies show that

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[103] *See Ensuring Appropriate Regulatory Oversight of Broker-Dealers and Legislative Proposals to Improve Investment Adviser Oversight*, Hearings Before the H. Subcomm. on Capital Mkts. and Gov't Sponsored Enters., 112th Cong. 128 (2011) (statement of Barbara Roper, Director of Investor Protection, Consumer Federation of America), available at https://financialservices.house.gov/uploadedfiles/112-58.pdf.
[104] *See* Francis J. Facciolo, *Do I Have A Bridge for You: Fiduciary Duties and Investment Advice*, 17 U. Pa. J. Bus. L. 101, 110 (2014)
[105] *Id.* (citing Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC*, 56 Stan. L. Rev. 1, 7-9 (2003)).
[106] *Id.* at 111 (citing Daylian M. Cain et al., *When Sunlight Fails to Disinfect: Understanding the Perverse Effects of Disclosing Conflicts of Interests*, 37 J. Consumer Res. 836, 837 (2011) (discussing prior research)).
[107] Robert A. Prentice, Moral Equilibrium: Stock Brokers and the Limits of Disclosure, 2011 Wis. L. Rev. 1059, 1099 (2011) (citing Max H. Bazerman & Ann E. Tenbrunsel, *Blind Spots: Why We Fail To Do What's Right and What To Do About It* 116 (2011)).
[108] See SEC Office of Investor Education and Advocacy, *Study Regarding Financial Literacy Among Investors* (August 2012) (the "Financial Literacy Study"), available at http://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf.

investors lack critical knowledge that would help them protect themselves from investment fraud. In particular, surveys demonstrate that certain subgroups, including women, African-Americans, Hispanics, the oldest segment of the elderly population, and those who are poorly educated, have an even greater lock of investment knowledge than the average general population.[109]

The Financial Literacy Study identified: "(i) methods to improve the timing, content, and format of disclosures; (ii) useful and relevant information for investors to consider when either selecting a financial intermediary or purchasing an investment product; and, (iii) methods to improve the transparency of expenses and conflicts of interest."[110]

It is important to note that mere disclosure is not sufficient to protect an investor or for a broker or investment adviser to satisfy his obligations to an investor.[111] Disclosures must be set forth in plain English. If the risks or the conflict cannot be adequately expressed to be fully understood by the client, the disclosure is meaningless.

Based on the overall ineffectiveness of disclosure, conflicts of interest cannot be wholly mitigated through disclosure. To the extent the SEC wishes to incorporate disclosure into its rulemaking, the SEC should look to Nevada's statutory fiduciary duty, which contains a disclosure requirement. That provision requires that "[a] financial planner shall disclose to a client, at the time advice is given, any gain the financial planner may receive, such as profit or commission, if the advice is followed."[112]

This form of disclosure may help customers assess any conflicts of interest. As the compensation to the recommending agent increases, we expect that investors will grow increasingly skeptical of the recommendations.

If the SEC were to proceed with a standards-of-conduct-based approach to potential regulatory action, it should follow the recommendation the SEC staff gave in 2012, when it recommended that "the standard of conduct for all . . . providing personalized investment advice about securities to retail customers . . . shall be 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."[113] Any standard adopted should be no less stringent than the DOL Rule.

The standards of conduct for brokers and investment advisers should be the same. Inconsistent standards generate needless confusion and create opportunities for intermediaries to profit through regulatory arbitrage by shifting transactions from one governing standard to another. As discussed above, many studies establish that the public does not understand the regulatory

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[109] *Id.* at 15 (citing Federal Research Division, Library of Congress, Financial Literacy Among Retail Investors in the United States (Dec. 30, 2011), attached to the Financial Literacy Study as Appendix 1).
[110] *Id.* at Executive Summary, iii-vi.
[111] *See In re Dept. of Enforcement v. Gerald J. Kesner Lakewood, Co.*, 2010 WL 781456, *9 (FINRA 2010); *see also In re Chase*, SEC Release No. 34-47476, 2003 WL 917974, *4 (SEC 2003) ("Mere disclosure of risks is not enough. A registered representative must 'be satisfied that the customer fully understands the risks involved and is ... able ... to take those risks.'" (quoting *In re Patrick G. Keel*, SEC Release No. 34-31716, 1993 WL 12348 (SEC 1993))).
[112] Nev. Rev. Stat. Ann. § 628A.020.
[113] SEC Study, *supra* note 4 at 109-10 (Jan. 2011).

distinctions between brokers and investment advisers. Most investors already believe their investment professional owes them a fiduciary duty. A harmonious standard for investment advice would reduce the opportunity for confusion and exploitation.[114]

Question: *If the Commission were to impose new requirements, should private remedies be available for violations of any new requirements? If so, in what venue or venues should such claims be brought? Should the Commission establish uniform rules, or should parties determine available remedies by contract, so long as not inconsistent with the securities laws?*

Private Remedies Should be Available for Violations of New Fiduciary Requirements

Private remedies should be available to the retail customers for violations of any new requirements the SEC imposes. A private right of action can supplement an agency's public enforcement.[115] Reinforcing the new rule through private remedies is also consistent with the overarching goal of the securities laws and regulations—which is to protect investors. Investors should have the ability to protect themselves through a private right of action. A fiduciary relationship is a relationship of trust between the financial advisor and the investor. When that trust is broken, investors must have a remedy available to them, else the fiduciary standard becomes meaningless.

It is not as though private remedies for securities sales violations are rare. Private remedies are available throughout the securities laws: Customers can sue under sections 11[116] and 12[117] of the Securities Act of 1933; under sections 21D,[118] 21F,[119] and 29[120] of the Securities Exchange Act of 1934. Additionally, investors can arbitrate under the rules promulgated by the FINRA if the contract provides for arbitration or the customer demands it.[121]

In order to fully and efficiently achieve the Congressional purpose to protect the investor, it is imperative that the SEC provide the private remedy for the violations of the rule upfront. Recognizing private remedies through judicial gloss of the "implied-right-of-action" has proved to be inefficient and limited in scope. Although Rule 10b-5 was first written in 1948,[122] it was not until 1971 that the United States Supreme Court recognized the private right of action for securities fraud pursuant to Rule 10b-5.[123] To avoid the unnecessary delay and ambiguities in

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[114] *See* Christine Lazaro & Benjamin P. Edwards, *The Fragmented Regulation of Investment Advice: A Call for Harmonization*, 4 Mich. Bus. & Entrepreneurial L. Rev. 47, 52 (2014) (explaining that "harmonizing standards for investment advice is the best solution to address the shortcomings of the existing regulatory systems").
[115] *See* Richard B. Stewart and Cass R. Sunstein, *Public Programs and Private Rights*, 95 Harv. L. Rev. 1193, 1214 (1982).
[116] 15 U.S.C. § 77k (civil liabilities on account of false registration statement).
[117] 15 U.S.C. § 77l (civil liabilities arising in connection with prospectuses and communications).
[118] 15 U.S.C. § 78u-4 (private securities litigation).
[119] 15 U.S.C. § 78u-6 (securities whistleblower incentives and protection).
[120]15 U.S.C. § 78j (manipulative and deceptive devices).
[121] FINRA Rules 10300 *et seq*.
[122] Employment of Manipulative and Deceptive Devices, 13 Fed. Reg. 8,183 (Dec. 22, 1948), *amended by* 16 Fed. Reg. 7,928 (Aug. 11, 1951).
[123] In 1964, the Supreme Court first took a permissive approach in *J. I. Case Co. v. Borak*, recognizing implied right to private actions upon finding that private remedies were necessary to effectuate congressional purpose to protect the investors. *See*, 377 U.S. 426, 433 (1964). Then it took another seven years before the Supreme Court expressly

protecting the investor's rights, the SEC should make private remedies explicit and available with the new regulation.

The SEC Should Establish Uniform Rules to Govern the Private Remedies

Retail consumers often lack the information and the bargaining power necessary to obtain fair contractual terms.[124] The SEC should establish uniform rules to govern the private remedies so that investors can benefit most from the new regulation.

Contractual limitation of remedies should be prohibited because they carry the risk of emasculating the fiduciary duty, or significantly reducing the protections to the retail investor. Therefore, it is necessary that the SEC establish a uniform rule to provide the retail investors with safeguards that protect them against unfair contract terms. Current laws and regulations already place some safeguards against contractual provisions that purport to limit the damages where the private right of action is allowed. Indemnification provisions that violate the SEC's public policy are unenforceable,[125] and provisions that limit the scope of liability or damages in violation of the existing laws and regulations are invalid.[126] Consistent with these existing principles, the SEC should consider disallowing contractual provisions that purport to indemnify the brokers from breach of fiduciary duties, limit the damages to net out-of-pocket losses, or confine the scope of liability to grossly negligent conduct.

Further, the Commission should prohibit mandatory class-action waivers by exercising its authority under section 15 of the Securities Exchange Act of 1934[127] to prohibit mandatory pre-dispute arbitration clauses.[128] Evidentiary burdens to prove breach of fiduciary duty can be too expensive for a single plaintiff to bear.[129] Therefore, pre-dispute class-action waivers could be cost-prohibitive for financially-harmed investors to seek private remedies.[130] Promulgating a rule that prohibits class action waivers is consistent with, and would solidify, FINRA's decision that a firm's practice requiring customers to waive their rights to bring class claims against member firms violates FINRA's rules.[131]

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recognized the private remedies for the violations of Rule 10b-5 in *Superintendent of Ins. of State of N. Y. v. Bankers Life & Cas. Co.* 404 U.S. 6, 13 n.9 (1971).

[124] *See* Stacy-Ann Evy, *Contracting in the Age of the Internet of Things: Article 2 of the UCC and Beyond* 44 Hofstra L. Rev. 839, 893–94 (2016) (on information asymmetry); *see generally*, Albert Choi and George Triantis, *The Effect of Bargaining Power on Contract Design*, 98 Va. L. Rev. 1665 (2012) (on how bargaining power asymmetry impacts contract design of nonprice terms).

[125] 17 C.F.R. § 230.484 (2017).

[126] *See* 15 U.S.C. § 78cc.

[127] *See* 15 U.S.C. § 78o(o).

[128] *See id.* (The SEC can prohibit or limit mandatory pre-dispute arbitration when doing so would be "in the public interest and for the protection of consumers.")

[129] For example, in ERISA breach of fiduciary duty cases, the courts have required plaintiffs to prove breach of fiduciary duty itself and the causal nexus between the breach and the loss in investment. *See, e.g.*, Holdeman v. Devine, 572 F.3d 1190, 1194 (10th Cir. 2009).

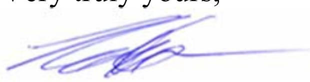
[130] Proving the requisite causations can be difficult. *See* Lauren N. Fromme, *Unreliable Securities for Retirement Income Security: Certifying the ERISA Stock-Drop Class*, 64 VAND. L. REV. 301, 328 (2011). To meet the evidentiary burden, expensive expert fees may be necessary for a plaintiff to prevail her claim. Thus, class actions can be cost-prohibitive to individual plaintiffs.

[131] *In the Matter of Department of Enforcement v. Charles Schwab & Company, Inc.* FINRA Complaint No. 2011029760201 (April 24, 2014).

<u>Conclusion</u>

PIABA thanks the SEC for the opportunity to comment on this important issue. PIABA looks forward to the SEC's rulemaking designed to unify the standards applicable to brokers and investment advisers.

Very truly yours,



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