September 11, 2017

Via Email to: rule-comments@sec.gov

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Comment on the Standards of Conduct for Investment Advisers and Broker-Dealers

Dear Chairman Clayton,

Bernardi Securities, Inc. (BSI) is pleased to submit this letter in response to your June 2017 release of "Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers." We appreciate the opportunity to comment on this important issue.

BSI is a Chicago based middle-market broker-dealer (B/D) founded in 1984 and specializes in the municipal bond marketplace. It serves investor and issuer clients across the country. Its activities focus on municipal bond underwriting, trading, and bond portfolio management on behalf of its investor clients. Additionally, Bernardi Asset Management, a subsidiary of BSI and a SEC registered investment advisory firm (RIA), manages bond portfolios as a fiduciary for investors nationwide.

I am the President and CEO of BSI and have committed my thirty-six year career to the municipal bond industry.

Our investor clients number in the thousands, including individuals in retirement or saving for retirement and community banks investing capital back into their localities. Our experiences, along with our role as a leading municipal bond market participant, give us a meaningful perspective on a range of important issues and potential Commission actions. Our letter discusses several substantive issues affecting investors, other market participants, market structure and liquidity. We offer our perspective in hopes of assisting the Commission as it examines and contemplates potential future actions on the issues enumerated in your June release. We appreciate the SEC's commitment to these issues and its recognition that investors and other parties seek **clear**, **consistent,** and **harmonized** regulation.

Here are the points we want to make:

1. **Investors' interests are primary:** We strongly believe in placing investors' interests ahead of a potentially competing financial interest of the adviser or broker-dealer.

- The June 2017 effective date of the DOL's Impartial Conduct Standards (ICS) is a welcome regulatory addition for retirement investors and all other market participants.
- A broker-dealer should be subject to one set of rules for all its retail clients.

2. **Drawbacks of the current DOL Rule**: We believe portions of the DOL Fiduciary Rule will have negative repercussions for investors.
   - Negative repercussions include: increased costs for certain buy and hold bond investors and diminished direct access to inventory selection.
   - Investor choice should be preserved. An enhanced standard of care mandate should not favor one business or compensation model over another.
   - We had several discussions with Department of Labor staff in 2016 in an attempt to minimize some of the negative repercussions of the rule. We also responded to the Department's 2017 "Request for Information" and repeated our concerns regarding several areas where the rule unnecessarily limits investors' choices.

3. **The regulatory regime should be harmonized**: Enhanced standards for B/Ds should be paired with the elimination of duplicative existing and pending rules.
   - Over many decades the standard of care has been greatly enhanced for B/D clients through the enactment of a complex body of rules written and enforced by multiple regulatory bodies (SEC, FINRA, MSRB, state regulatory agencies, DOL). Adding an enhanced SEC standard of care on top of the profound regulatory regime will further complicate and increase costs. In essence, we need to heighten the standard but simplify its application.

4. **Regulatory burden for small to medium sized enterprises**: When considering future and past actions the Commission should pay particular attention to smaller and regional broker-dealers who face a relatively larger regulatory burden versus their bulge bracket competitors.
   - As a medium-sized firm, we serve a vital role and provide high levels of service and expertise to our clients.
   - We have seen similar-sized competitors exit the industry or sell. This is not a good trend for market dynamics.

Since the SEC plays the primary role in developing, implementing and enforcing standards of conduct for RIA's and B/D's, we believe it should lead the effort to establish standards of care for both tax-advantaged and taxable accounts.

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We believe the currently effective DOL Fiduciary Rule's Impartial Conduct Standards could serve as a solid baseline for a SEC Best Interests Standard of Care. Additionally, it should be paired with efforts to harmonize the existing regulatory regime. Coordination with FINRA and its FINRA360 program, specifically the *Retrospective Rule Review,* should explore ways to streamline current rules into one holistic higher standard.

A properly crafted Best Interest Standard would mandate:

- Advice must be in the best interest of the client at the time the advice is given and a duty of loyalty and care to the client are primary
  - *Current rules largely address this: FINRA Rule 5310 - Best Execution, MSRB Rule G-19 - Suitability and FINRA Rule 2111- Suitability*
- Compensation must be reasonable
  - *Current rules largely address this: MSRB Rule G-30 - Reasonable Price and Commission rule and the Markup Disclosure Rule effective May 2018, which is based on a complex calculation of the "prevailing market price"*
- Statements about recommended investments, fees/compensation, material conflicts of interest and any other relevant matters are not misleading at the time they are made. Additionally, all material information known about the transaction, as well as material information about the security that is reasonably accessible to the market must be disclosed to the purchaser or seller of securities.
  - *Current rules largely address this: FINRA Rule 2210 and MSRB Rule G-47*

All broker-dealers should be required to adopt policies and procedures designed to ensure compliance with the newly adopted Best Interest Standard and there should be a "hold harmless" carve out for unsolicited trades directed by the client.

The above referenced rules are just a few of the existing rules that already require a B/D to "observe high standards of commercial honor and just and equitable principals of trade." As an example, The FINRA suitability rule requires a broker–dealer recommendation to be in concert with a customer's interests. Therefore, harmonizing the new standard with existing rules, and streamlining firm compliance and oversight should be considered.

In my numerous conversations with clients I have been told they seek the following from their RIA or B/D:

- Investment management options (advisory fee-based or commission based brokerage) rather than regulatory imposed dictates
- Transparency regarding costs and fees and other material facts/potential conflicts relating to the relationship between the RIA or B/D
- Upfront disclosure regarding the role and applicable standards their RIA or B/D must adhere to
- Reasonably priced investment management services and upfront explanations of their scope

The marketplace has evolved over the years and regulatory initiatives, in part, have helped foster this development. The Commission's historical disclosure-based approach has proven to be very effective in regulating conflicts of interest. A recent successful example is the SEC Municipal Advisor Rule implemented in 2014. The bottom line effect of this rule is it ensures municipal issuer officials understand the responsibilities and relationship of the advisor and/or broker-dealer it selects to finance a project. The rule helps officials make an informed decision as to whether to hire an M/A, a B/D or both. **Importantly, the rule was crafted in a way that allows issuers a choice rather than mandating (directly or indirectly) which model to favor.**

Building a more stringent standard of care should not be overly prescriptive. A disclosure-based rule that does not limit investor choice outright or favor one business model over the other is most appropriate**. A major drawback of the DOL Fiduciary rule for some investors is that it creates ersatz obstacles effectively eliminating a less expensive brokerage account option for them.** It fails to recognize the long standing distinction between the B/D "selling" model and the RIA "advising" model. Different investors prefer one model over the other and have the ability to discern the differences and decide for themselves. The DOL rule creates barriers that in many instances limits investor choice, increases investor cost, and in some instances prevents them from accessing professionals whose advice they seek.

Investors are well served by a market where both asset-based pricing and transaction-based pricing models co-exist and where they are able to decide which model is best for their needs; "a one size fit all" approach is not right for everyone. Each model serves an important purpose for investors and implementing a well-thought out standard of care regime should foster the continuing development of both business models.

Please consider these alternative Standards of Conduct options for retirement account and non-retirement account investors:

- maintain the current Fiduciary Standard as promulgated in the Investment Advisers Act of 1940 as it has worked well for investors seeking fee only, fiduciary management. **This standard would apply to all fee based, discretionary registered investment advisers (RIAs).**

- a "Best Interest Standard" that includes mandates as described earlier- **this standard would apply to all non-discretionary (self-directed) and discretionary transaction based, broker-dealer relationships**. This standard would allow for conflicts/potential conflicts which must be disclosed and fairly managed and in client's favor. This allowance ensures investors have access to investments they often seek from their B/D while the disclosure and standards requirements ensure they will be fully aware of all material facts and well-informed before making a decision.

Providing investors with a choice of stringently defined standards of conduct will provide them with needed clarity of available choices. **Any standard of conduct revision should permit the use of transaction based compensation because many investors seek and understand this model. Decades of experience have shown me it represents a very good value for investors who seek a low turnover, high quality, bond portfolio.**

Additionally, any revised standard should permit the sale of proprietary products and allow for principal transactions. In fact, Section 913(g) of the Dodd Frank Act requires that any industry wide standard of conduct allow for this. We recognize the principal trading issue is a difficult one to navigate for the SEC when addressing an enhanced standard of conduct. We understand a broker-dealer acting as principal with clients raises the potential for self-dealing. **For this reason, years ago our firm implemented robust policies to inform and protect our portfolio managed investor clients from this potential conflict even though no rule required such disclosure or policy.** I can tell you from first-hand experience it has been very well received by our clients.

It is important to bear in mind that many B/D accounts are non-discretionary because the investor chooses not to grant trading discretion. Therefore, any rule requiring "agency only" transactions will make the relationship between the investor and B/D unnecessarily difficult to coordinate. Additionally, many municipal bond investors actively seek to buy unique inventory positions under the control (as a principal) of their preferred B/D. We believe no rule should limit investor access to these investment opportunities. Lastly, when our B/D investor clients need to sell positions they often benefit because they receive a higher price by selling to our B/D in a principal capacity rather than selling at a lower price to other market bids we receive for them on an agency basis. ***In all of these instances,*** **the use of our B/D balance sheet benefits our clients. We believe regulations should not eliminate or diminish these potential investor benefits, none of which the RIA model provides**. In summary, any conduct standard prohibiting principal transactions (directly or indirectly by creating a complicated exemption regulatory maze) limits investor choice in a way that can be detrimental to their financial well-being.

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Importantly, in order to mitigate much of the existing widespread investor confusion, a standardized, straightforward, and truthful disclosure regime is needed for all B/D relationships. Years ago we began providing our portfolio managed B/D clients a "Statement of Understanding" (a "light" version of ADV Part 2a) and have found they understand and appreciate its transparent and complete nature. The disclosure should describe:

- the applicable standard of conduct and scope of the B/D's services and responsibilities which vary depending on whether the client exercises independent control over the account
- all fees/commissions earned (direct/indirect, pricing discounts received)
- all material/potential conflicts of interest and it should describe firm's policies and procedures designed to mitigate them and ensure they are fairly managed in the client's favor

Over the years we have been dismayed by certain practices that confuse investors leading them to mistakenly conclude something about a relationship with their adviser or broker. Here are three current examples:

- An investor believes the only expense he/she is incurring is a quarterly RIA fiduciary advisory fee, when in fact, the adviser is receiving either hard/soft dollar credits from a custodian or vendor it favors or is required to direct a certain amount of trading activity to a particular party. Such arrangements should be prominently disclosed.

- A major national brokerage company prominently advertising "see why it can be better to buy your bonds here for $1 per bond". A footnote at the bottom of the page explains its affiliated broker may add a separate mark-up/down and may realize a profit beyond the "$1 per bond". The lack of a prominent display that a mark-up exists is wrong and mischaracterizes the true cost to investors. There are several firms that employ this scheme.
- A major national brokerage company advertising "industry low fees….trade new issues for free" with a footnote at the page bottom disclosing that it "may receive compensation from issuers for participating….".

These are all embarrassing examples of certain market participants playing around the regulatory edges and are an embarrassment to our industry. This misbehavior confuses investors and serves to obfuscate the decision making process for investors.

Any contemplated heightened Standard of Conduct should address these topics in order to better protect investors' interests. Standardizing a robust, thorough disclosure regime will accomplish this.

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In recent years there has been a significant decline in the number of broker-dealers nationally. Additionally, capital committed to bond departments at a number of the largest bulge bracket firms has declined, while several major firms have exited the municipal bond business entirely. These changes may affect market liquidity, especially if a steep bond market sell-off occurs.

Some of this activity is a healthy and a natural evolution of the financial industry landscape. But certain regulations have encouraged and accelerated this shift from principal based brokerage relationships to advisory relationships.

Over emphasis on fees and product costs as a regulatory determinant overlooks the numerous facets broker-dealers and advisers consider when providing advice in the best interest of their clients. If cost is the sole determinant it will drive the available product/service offering platform to the least common denominator creating an advice vacuum for some investors. This narrow approach will not serve investors well in the long run. Some investors in the United Kingdom are now experiencing this negative repercussion 5 years after it enacted a law that banned commissions on certain investment products.

We believe regulatory policy mandates should strike a balance between being too lax and too onerous. The former may expose the economy to unnecessary risk, while the latter chokes economic and job growth, weakens market structure, and rewards large firms at the expense of smaller competitors. The decrease in the number of brokerage firms over the years and the high regulatory barriers to entry are reasons the industry has shrunk.

We support regulatory changes that enhance investor confidence, protect investor choice while avoiding favoring one business model over another.

We are thankful the Commission is providing this opportunity for public comment as these are important issues for investors and for all market participants. For many years we have attempted to be leaders in the municipal marketplace on a range of issues including those we have discussed in our letter. I hope our comments are helpful. We welcome any feedback and stand ready to assist the Commission in its efforts in any way you think is useful.

Sincerely,

Ronald P. Bernardi
President & CEO
Bernardi Securities, Inc.

CC Robert Cook, Chairman and CEO, FINRA
Robert Colby, Chief Legal Officer, FINRA