VIA ELECTRONIC MAIL

October 30, 2017

Chairman Jay Clayton
Securities and Exchange Commission
100 F Street NE
Washington DC, 20549

Re: Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker Dealers

Dear Chairman Clayton:

On June 1, the Securities and Exchange Commission (SEC) published a request in advance of any future SEC action for public comment on standards of conduct applicable to investment advisers and broker dealers when they provide investment advice to retail investors (Request for Comment).[1] The Request for Comment will inform the SEC's examination of the standards of conduct applicable to broker-dealers and investment advisors and related matters.

The Financial Services Institute[2] (FSI) appreciates the opportunity to respond to this important request for comment. FSI members support a uniform best interest standard of care that is applicable to all professionals providing personalized investment advice to retail clients and enforced by the SEC as the appropriate jurisdictional agency. Such a standard should incorporate duties of care and loyalty, and require reasonable and streamlined disclosures to ensure industry participants effectively communicate their conflicts of interest to their clients and potential clients. We provide more detailed feedback in our comments below.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives.[3] These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).

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[1] Public Statement, Jay Clayton, Chairman, U.S. Securities and Exchange Commission (June 1, 2017) *available at:* https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31.

[2] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

[3] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners with strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate $48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly $6.8 billion annually to federal, state, and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity.[4]

Discussion

FSI appreciates the opportunity to respond to the SEC's request for comment. Since 2009, FSI has publicly supported a carefully-crafted, uniform "best interest" standard of care applicable to all professionals providing personalized investment advice to retail clients.[5] Indeed, Congress specifically charged the SEC with evaluating the effectiveness of existing standards of care and delegated the authority to promulgate a uniform standard of care for broker-dealers and investment advisers.[6] FSI has been actively engaged in the debate surrounding the final form of such a standard and has provided the SEC with detailed comments in response to earlier requests.[7]

FSI believes any future rulemaking should build upon, and fit seamlessly within, the existing and long-standing securities regulatory regime for broker-dealers and investment advisers, while being supported by robust examination, oversight and enforcement by the SEC, FINRA and state securities regulators. Further, we agree with Chairman Clayton that a uniform standard "should be clear and comprehensible to the average investor, consistent across retirement and non-retirement assets and coordinated with other regulatory entities, including the Department of Labor (DOL) and state insurance regulators."[8]

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dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

[4] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016).

[5] *See, e.g.*, Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (Jul. 5, 2013) (commenting on Duties of Brokers, Dealers, and Investment Advisors, Release No. 34-69013; IA-3558; File No. 4-606), *available at* https://www.sec.gov/comments/4-606/4606-3138.pdf.

[6] Dodd Frank Wall Street Reform and Consumer Protection Act §913, 12 U.S.C. 5301 (2010).

[7] *See, e.g.,* Bellaire Letter *supra* note 5; Letter from Dale E. Brown, President & CEO, Financial Services Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (August 30, 2010) (on file with author).

[8] *Oversight of the U.S. Securities and Exchange Commission: Hearing Before the Senate Committee on Banking, Housing and Urban* Affairs, 115th Congress (2017) (testimony of Jay Clayton, Chairman, U.S. Securities and Exchange

In developing a uniform best interest standard of care, we suggest that the key questions for the SEC to address include: defining a best interest standard of care; determining how Financial Institutions[9] would demonstrate compliance; the means to address investor concerns or complaints; and ensuring investors retain access to investment products, services and advice. Answering these questions will help the Commission develop a manageable regulatory framework consisting of a clear standard; a benchmark by which financial institutions and regulators can measure compliance with the standard; and a mechanism to ensure that investor grievances are properly disclosed and remediated. Further, it is critical that the Commission meets these objectives without sacrificing investors' access to affordable products, necessary services or skilled investment advice. We expand on these comments below.

I. Defining a "best interest" standard of care

FSI members believe that acting in their client's "best interest" means that a financial advisor shall: place the interests of their client before their own; avoid material conflicts of interest when possible or obtain informed client consent to act when such conflicts cannot be reasonably avoided; and provide advice and service with skill, care and diligence based upon the information known about their client's investment objectives, risk tolerance, financial situation and needs. This "best-interest" standard incorporates duties of care and loyalty[10] and other similar standards applicable under federal securities laws,[11] but it expressly excludes basic financial planning services where no specific personalized advice is given and other activities as set forth in more detail in Section V(E) infra.

Further, we contend that the SEC can integrate any future standard of care into the investor protections provided by the existing regulatory framework. To accomplish this, FSI suggests that Financial Institutions and financial advisors be required to implement policies and procedures reasonably designed to manage material conflicts of interest; and where such conflicts cannot be avoided, to adhere to a two-tiered disclosure regime consisting of a concise disclosure document to be supplemented with more detailed disclosures posted to the Financial Institution's web site. We explain our suggested policies and procedures requirements and the recommended disclosure regime in greater detail below.

II. Demonstrating Compliance

A. Conflicts of Interest

A "best interest" standard does not require firms and advisors to maintain a conflict-free culture, but only that these conflicts be adequately addressed to ensure that the Financial

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Commission) *available at:* https://www.banking.senate.gov/public/_cache/files/900a13d9-8f32-4608-8b4f-7e7bd7935483/21DC29002FF339CE52300B7FA9B3D454.clayton-testimony-9-26-17.pdf

[9] Broker-Dealers and Registered Investment Advisers and other similarly situated entities, hereinafter collectively referred to as Financial Institutions.

[10] Thus, while this suggested standard of care would require a financial advisor to provide advice that is in the best interest of the customer, it would not necessarily require recommending the lowest cost investment option. Cost would be an important factor in assessing the appropriateness of an investment recommendation, but not the only factor. See, e.g., Advisory Opinion 2002-14.

[11] See, e.g., FINRA Rule 2111. It has long been recognized that a broker-dealer has a duty to deal fairly with the public. See Charles Hughes & Co. v. SEC, 139 F.2d 434 (2d Cir. 1943), cert. denied, 321 U.S. 786 (1944), FINRA Rule 2010 and FINRA Supplementary Material 2111.01.

Institutions' and financial advisors' interests align with those of their customer. Thus, the best interest standard must be designed to appropriately address conflicts of interest because they may arise in any relationship where a duty of care or trust exists between two or more parties.[12] Indeed, being completely "conflict free" is not possible for financial advisors, as Wall Street Journal columnist Jason Zweig explains, "All financial advis[ors]—like all people who perform a service for anyone else, including journalists—have conflicts of interest. That's true regardless of whether they work for someone else or for themselves, whether they earn fees or commissions, or whether they call themselves 'fiduciaries' who put clients' interests ahead of their own."[13]

Acknowledging the risk of investor harm if conflicts of interest are not managed appropriately, FINRA released a Report on Conflicts of Interest (Conflicts Report), which identifies effective practices used by firms to manage and mitigate conflicts in their businesses.[14] FINRA explains that the issue of conflicts is complex and pervasive, varying based on firm size, product manufacturing and distribution methods. The Conflicts Report emphasizes the importance of a strong conflict management framework. We recommend that any SEC rulemaking require firms to develop and implement policies reasonably designed to identify, manage and mitigate conflicts. Given the complexity of the subject, the fast pace of industry innovation, and the firm-specific nature of conflicts, it is important that such a rulemaking take a principles-based approach to allow firms to tailor their policies and procedures to their unique business models.

Just as no rulemaking should be expected to eliminate all conflicts, which are inherent and unavoidable, no proposal can address conflicts through excessive and duplicative disclosures. Experience shows that investors already ignore much of the enormous volume of regulatory disclosures they are being provided. Instead, a more realistic approach is to require Financial Institutions to adopt written supervisory procedures to detect and manage conflicts of interest, to avoid those they can and take steps to mitigate the impact of those conflicts that can't be avoided. More specifically, these procedures would require the Financial Institution to: (i) Identify conflicts of interest inherent in their business model, means of product distribution or service model; (ii) Assess whether each conflict is material; and (iii) Develop a means of avoiding the conflict, mitigating its impact and/or disclosing the conflict to the customer if the conflict is material. Like all written supervisory procedures, these should be tailored to the Financial Institutions' business operations.

B. Nature of Disclosure Obligations

Firms' and advisors' disclosure obligations should address material conflicts arising in a firm's specific business model. Experience has demonstrated that more disclosure does not result in better disclosure. For example, the 1999 Gramm-Leach-Bliley Act required banks and other financial institutions to make very detailed annual privacy policy disclosures to consumers. Critics contended that the resulting notices were long, complex, and written in legalistic jargon that was difficult for consumers to understand. In 2006, Congress directed the financial regulatory agencies

[12] FINRA, Report on Conflicts of Interest (October 2013) *available at* https://www.finra.org/sites/default/files/Industry/p359971.pdf.
[13] Jason Zweig, *Why Your Financial Adviser Can't be Conflict Free*, The Wall Street Journal (April 7, 2017) *available at*: http://jasonzweig.com/why-your-financial-adviser-cant-be-conflict-free/.
[14] FINRA Report *supra* note 12.

to jointly develop a streamlined model financial privacy form.[15] Consumer testing commissioned by the agencies showed that consumers were more likely to read notices that were simple, provided key context up front, and had pleasing design elements, such as large amounts of white space. This testing indicated that notice in the form of a table was more effective than the long notice originally required by Gramm-Leach-Bliley, which performed poorly on all measures.[16] These findings were successfully incorporated into the agencies' model form. The SEC would be wise to apply these lessons to conflict disclosures.[17]

Indeed, the SEC has significant expertise related to investor disclosure regimes and is well positioned to draft model disclosures to maximize their effectiveness. As SEC Commissioner Michael Piwowar observed in his comments on the most recent DOL Request for Information, the SEC has historically made great effort to ensure the accuracy and effectiveness of disclosures to investors.[18] He pointed to the work of the Office of the Investor Advocate's Policy Oriented Stakeholder and Investor Testing for Innovative and Effective Regulation (POSITIER) Initiative, which is engaged in an evidence-based study of the impacts of proposed policy changes, including disclosure-oriented policies. He contended that, "[r]ather than dismiss out of hand the role of disclosure in policing conflicts of interest, I would strongly encourage the Department to redouble its efforts to work with the Commission and its expert staff, who may bring to bear our decades of experience in enforcing multiple disclosure-based regimes."[19] FSI agrees with Commissioner Piwowar and encourages the SEC to put its expertise to use to create an effective disclosure regime to educate investors.

FSI suggests that firms be required to implement a two-tier client disclosure regime consisting of a concise point of sale disclosure document at the time a formal engagement is entered into for new accounts that would be supplemented with more detailed disclosures posted to the Financial Institution's web site. The first-tier disclosure will serve to inform investors of the information that is most critical to their decision making at the point in time when that information is most useful and can be delivered most efficiently. Thus, these disclosures ensure that customers understand the best interest standard of care owed to them by the Financial Institution and the financial advisor. For example, the information detailed on the first-tier disclosure may include:[20]

- A statement of the best interest standard of care owed by the Financial Institution to the client;
- The nature and scope of the business relationship between the parties, the services to be provided, and the duration of the engagement;
- A general description of the nature and scope of compensation to be received by the Financial Institution and financial advisor;

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[15] Peter Swire & Kenesa Ahmad, Investment Company Institute, Delivering ERISA Disclosure for Defined Contribution Plans: Why the time has come to prefer electronic delivery (June 2011) *available at:* https://www.ici.org/pdf/ppr_11_disclosure_dc.pdf.
[16] *Id.*
[17] Final Model Privacy Form under the Gramm-Leach-Bliley Act, 17 CFR Part 248 (2009) *available at:* https://www.sec.gov/rules/final/2009/34-61003.pdf.
[18] Letter from Commissioner Michael S. Piwowar, U.S. Securities and Exchange Commission, to the DOL Employee Benefits Security Administration (July 25, 2017) *available at* https://www.sec.gov/news/public-statement/piwowar-comment-dol-fiduciary-rule-prohibited-transaction-exemptions.
[19] *Id.*
[20] A suggested example of the short-form disclosure is attached as an appendix.

- A general description of any material conflicts of interest that may exist between the Financial Institution, financial advisor and investor;
- An explanation of the investor's obligation to provide the Financial Institution with information regarding the investor's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other relevant information the customer may choose to disclose, as well as an explanation of the investor's obligation to inform the Financial Institution of any material changes;
- A statement explaining that customers may research the Financial Institution and its financial advisors through FINRA's BrokerCheck database or the Investment Adviser Registration Depository (IARD);
- A phone number and/or e-mail address the investor can use to contact the Financial Institution regarding any concerns about the advice or service they have received; and
- A description of the means by which a customer can obtain more detailed information regarding these issues, free of charge, including a link to the section of the Financial Institution's website featuring the second-tier disclosures.[21]

Financial Institutions would be able to include additional information on the first-tier disclosure should they choose to do so. However, any additional information must ensure that it does not detrimentally impact the ability of the investor to understand the material, nor does it oversaturate the investor with information. Similar to the Model Privacy Form developed under Gramm-Leach-Bliley, the SEC could develop a model short-form disclosure to satisfy the first-tier disclosure requirement and provide safe harbor protections for those that use it.[22] For existing account holders, the first-tier disclosures could be provided at the time a transaction is first effected subsequent to the implementation date.

The second-tier disclosure would provide investors with access to detailed compensation and material conflicts information via the Financial Institution's website or, upon request, in hard copy.[23]The website would provide investors with detailed information concerning available investments, considerations for making investment decisions, and information explaining how a financial advisor and a Financial Institution receive compensation for each type of product. The disclosures would be designed to allow investors to better understand both the existence of payments to be made to the Financial Institution and the purposes of such payments, similar to existing revenue sharing disclosure obligations.[24] Presenting disclosures in an electronic format allows them to be easily updated by the Financial Institution, and to be easily searchable by

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[21] A hard copy of the second-tier disclosure would be provided upon request.
[22] See "Final Model Privacy Form Under the Gramm-Leach-Bliley Act," 74 Fed. Reg. 62965 (codified by FTC at 16 C.F.R. Part 313) (2009), available at http://www.ftc.gov/privacy/privacyinitiatives/PrivacyModelForm_FR.pdf.
[23] The SEC could provide safe harbor to Financial Institutions who use a Form ADV or a disclosure similar to an ADV to satisfy this second-tier disclosure.
[24] *See* Edward D. Jones & Co., Admin. Proc. File No. 3-11780 (U.S. Securities and Exchange Commission December 22, 2004). The Settlement Order required Edward Jones to maintain on a public website disclosures regarding its revenue sharing program, including: (i) the existence of the program; (ii) the product providers participating in the program; (iii) the amount of revenue sharing payments that the firm receives from each of the product providers based on a reasonable estimate from historical experience, expressed in basis points or dollars ; (iv) the total amount of revenue sharing payments (expressed in dollars) that the firm receives annually; (v) the source of such payments (fund assets, adviser, distributor, underwriter, etc.); (vi) that its financial advisors and the equity owners of the firm may benefit financially from the revenue sharing payments the firm receives; and (vii) that the firm does not receive revenue sharing payments from any non-preferred product providers.

customers. For example, the expanded disclosures featured on Financial Institution's website could include:

- A detailed schedule of typical account fees and service charges;
- Hyperlinks to product manufacturer's websites that provide Information for each type of packaged product (e.g., mutual funds, variable annuities, unit investment trusts, etc.) that includes:
    - Educational information describing the product,
    - Considerations for selecting a particular share class and education around selecting share classes (if applicable);
    - Narrative descriptions of the types of arrangements in which the Financial Institution receives an economic benefit from a product manufacturer;
    - The narrative descriptions should include a statement on whether these arrangements impact financial advisor compensation; and
    - A list of all product manufacturers with whom the Financial Institution maintains arrangements that provide economic benefits to either the financial advisor or the Financial Institution along with a narrative description of the benefits associated with any tiers within the program.

III. Addressing Client Concerns

Another issue that must be addressed is how to deal with investor concerns that the best interest standard has been violated. FSI believes that the current regulatory framework already provides mechanisms to address these concerns, but would be supplemented by the first-tier of the suggested two-tier disclosure model discussed above. The first-tier disclosure would provide customers with a formal process to raise questions and concerns they may have with the Financial Institution about the advice or service they receive either by phone or email. Broker-dealers are already required to have policies and procedures in place to supervise registered representatives and are periodically examined by regulators to ensure that these policies and procedures are followed, providing a further layer of supervision. Customers can also raise concerns through the FINRA arbitration process.

The existing framework provides various avenues to address customer concerns. Firms are subject to periodic examinations by FINRA and the SEC, have clear and concise self-reporting obligations and FINRA provides a forum for aggrieved customers to bring claims. FINRA subjects its member firms to periodic examinations, but may also initiate an examination for cause in response to a customer complaint, a tip, or other circumstances FINRA believes warrant such an examination. Examination findings may result in disciplinary action, including formal disciplinary action by FINRA's Department of Enforcement. Further, firms are required to self-report a litany of events, including customer claims[25] and both firms and advisors registered with FINRA are subject to the FINRA arbitration process. Investors can bring an arbitration claim against a FINRA member broker-dealer or advisor within six years of events giving rise to the dispute. The arbitration panel's decision is final and binding on all the parties.

[25] *See* FINRA Rule 4530 *available at*: http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=16260&element_id=9819&highlight=4530#r16260

Many IBD firms are dually registered with the SEC as broker-dealers and registered investment advisers (RIAs) with overlapping compliance requirements. [26] For instance, both broker-dealers and RIAs are required to implement written policies and procedures designed to achieve compliance with applicable securities laws and regulations, including FINRA rules. Broker-dealers are also required to supervise the activities of each registered representative or other associated person to ensure their compliance with those written policies and procedures. In addition, under the Investment Advisers Act of 1940, RIAs are subject to (i) fiduciary duties to clients; (ii) substantive prohibitions and requirements; (iii) contractual requirements; (iv) recordkeeping requirements; and (v) inspection by the SEC's Office of Inspections, Compliance and Examinations (OCIE). There are three general types of inspections: examinations of high-risk investment advisers; special purpose reviews (risk-targeted examination sweeps regarding specific areas of concern across the financial services industry); and cause examinations (resulting from a complaint or tip).

IV. Preserving Investor Access to Products and Advice

Much of the benefit of retirement planning services results from an advisor's ability to encourage product diversification, and behavioral coaching: encouraging savings; establishing and maintaining long term strategies; and eliminating the emotional decision-making that often arises during periods of market volatility. These benefits are especially critical for lower and middle-class investors and it is imperative that they have access to financial education and guidance. Research shows that investors who work with financial advisors save more, are better prepared for their retirement, and have greater confidence in their retirement planning. For example, a study of the positive value of financial advice found that the investment assets of households working with a financial advisor gained 69% more value after four years and grew to 290% more value over 15 years, which is 3.9 times the value of assets of a non-advised household.[27] Another study published by Vanguard estimates that access to an advisor adds 300 basis points to an investor's expected return.[28]

Unfortunately, we see a growing body of evidence demonstrating that the DOL's Fiduciary Rule (Fiduciary Rule) is resulting in higher costs for the industry, which are passed to consumers in the form of reduced product choices and a loss of access to much needed retirement planning services. We strongly urge the SEC to view responses to this request in light of the current difficulties and unintended consequences of the Fiduciary Rule and ensure any action taken by the SEC avoids the challenges and consequences caused by the Fiduciary Rule. FSI recently commissioned Oxford Economics to survey its members regarding their experiences preparing for and implementing the Fiduciary Rule.[29] This survey found that the Fiduciary Rule is resulting in a reduction in product choice that was not included in the DOL's initial cost-benefit analysis while promulgating the rule. Any future standard of care should further the SEC's mission of investor

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[26] The broker-dealer regulatory scheme is contained in the Securities Exchange Act of 1934; the investment advisor regulatory scheme is contained in the Investment Advisers Act of 1940.

[27] Claude Montmarquette, Nathalie Viennot-Briot. Centre for Interuniversity Research and Analysis on Organizations (CIRANO), *The Gamma Factor and the Value of Advice of a Financial Advisor, available at* https://www.cirano.qc.ca/files/publications/2016s-35.pdf

[28] Kinniry, Jaconetti, DiJosespeh, Zibering & Bennyhoff, Vanguard Research, *Putting a value on your value: Quantifying Vanguard Advisor's Alpha* (September, 2016). *See also*: David Blanchett & Paul Kaplan, Morningstar, *Alpha, Beta and Now…Gamma* (2013) *available at* http://corporate.morningstar.com/euconf3/presentations/David%20Blanchett,%20Morningstar.pdf; Marsden, Mitchell et. al., *The Value of Seeking Financial Advice*, Journal of Family and Economic Issues 32(4): 625-643 (2011).

[29] Oxford Economics for the Financial Services Institute, Encouraging Market Alternatives to the Fiduciary Rule (2017).

protection, but not at the expense of their retirement savings. In recent remarks before the Senate Banking Committee and the House Financial Services Committee, Chairman Clayton has emphasized the importance of preserving investors' access to advice and product choice.[30] In considering future action, the SEC should seek to avoid the negative consequences of the Fiduciary Rule, some of which we highlight below.

A. Smaller investors are losing access to advising services

The combination of lower fees and high fixed transaction costs resulting from the Fiduciary Rule means that it is no longer economical for many financial advisors to serve smaller clients. Whereas all firms interviewed for the study reiterated their commitment to meeting the needs of smaller investors, many suggested that below certain asset levels smaller investors will be directed to web-based products that do not rely on a financial advisor. The range of asset size at which this transition is expected to occur varied from $25,000 to $70,000 in assets per firm interviewed.[31] Moreover, financial advisors are small business with their own overhead expenses to cover; consequently, they indicated to us that their breakeven point may be higher still.[32]

The benefit calculation that the DOL used throughout its rulemaking process undervalued holistic financial and retirement planning services by equating variance in the performance between and within products as being a valid measure of the value of retirement planning services. Regrettably, this miscalculation will have significant consequences to investors who lose access to retirement planning services. As part of any future action, we urge the SEC to take into account the value of advice and financial planning services, particularly for small investors, who need it most.

B. Multiple standards of care require large amounts of redundant and unproductive paperwork and invite litigation to settle disputes

The DOL created the private right of action in the BICE because it lacks another enforcement mechanism. However, other financial regulatory agencies have robust enforcement programs, with which the DOL could coordinate to leverage their expertise and infrastructure. Indeed, the Fiduciary Rule is already relying on enforcement support from the securities and banking regulators in order to administer the PTEs.

As FINRA observed in its comments on the proposed Fiduciary Rule: [33]

> The Proposal would impose a best interest standard on broker-dealers that differs significantly from the fiduciary standard applicable to investment advisers registered under the federal and state securities laws, and it would impose the best interest standard only on retirement accounts. This fractured approach will confuse retirement investors,

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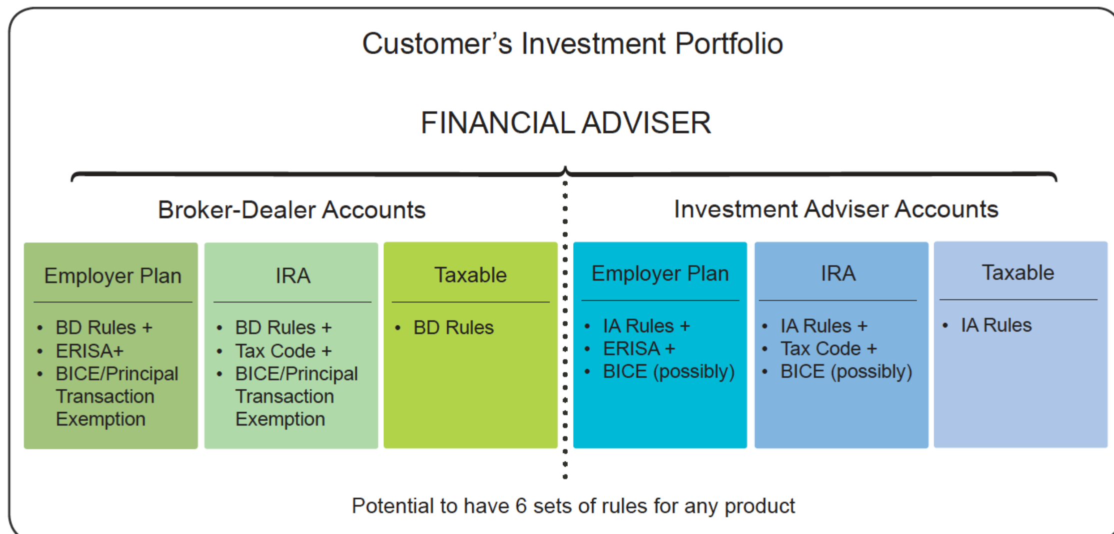
[30] Senate Banking Hearing *supra* note 8; *Examining the SEC's Agenda, Operations, and Budget: Hearing Before the House Financial Services Committee*, 115th Congress (2017).
[31] *Id.* at 26.
[32] *Id.*
[33] Letter from Marcia Asquith, Senior Vice President and Corporate Secretary, Financial Industry Regulatory Authority, to Department of Labor, Employee Benefits Security Administration (July 17, 2015) *available at:* https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00405.pdf https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00405.pdf.

financial institutions, and advisers. Below is a depiction of the panoply of regulatory regimes that will apply under the Proposal to different accounts served by the same financial adviser for a single customer.



The increased costs of complying with overlapping regulatory regimes, some of which rely on private litigation to enforce its complex requirements, is causing higher prices and reduced investor access to retirement planning services. These problems can be addressed most effectively through increased coordination and cooperation between the relevant regulatory authorities. Unlike the DOL, the SEC has existing examination and enforcement protocols and trained staff to perform these important functions.

In contrast to forcing the industry to pay millions of dollars to plaintiffs' attorneys, just to settle cases outside of their merits, leveraging existing information sharing arrangements and entering into memoranda of understanding with other enforcement agencies ensures that amounts recovered benefit the investor and penalties paid go back into the regulatory system to cover the costs of enforcement. Moreover, placing enforcement in the hands of more experienced financial regulators means less likelihood of frivolous suits, reducing costs to the system and producing more direct action against actual wrongdoers.

C. Reduced Product Choice

As previously discussed, FSI members indicate that the DOL's Fiduciary Rule is resulting in a reduction in product choice that was not explicitly included in the cost-benefit analysis performed by the DOL during the rulemaking process. Our members indicate they are limiting product choice in response to the Fiduciary Rule for several reasons, including: the large fixed costs to establish the necessary data feeds from product manufacturers and mutual fund families; the increased risk of class action and other litigation; and the complexity of compliance. These factors are causing firms to alter their business strategies in ways that limit the investment vehicles they offer to investors. For instance, many firms are considering whether they must eliminate A-Share mutual fund offerings, the low cost direct-to fund business, and other offerings that benefit investors. This

leads us to conclude that, the DOL overstated the Fiduciary Rule's benefits by failing to account for the reduction in product choice.

V. Response to Other Questions in the Request for Comment

A. How should advances in technology affect the SEC's consideration of future actions?

Prior to adopting new action, the Commission should consider whether investor risk, if any, is adequately addressed by current regulation. In 2016, FINRA published a Report on Digital Investment Advice (the Report) reminding broker-dealers' of their obligations when dispensing advice through digital investment tools.[34] The Report reminds firms that their supervisory, suitability and other regulatory obligations are applicable in the digital context. Creating varying obligations for digital advice, versus investment advice dispensed by other means, may be confusing to Financial Institutions, financial advisors and investors. Concerning the latter, these disparate standards would conflict with investors' understandable assumption that advice, no matter how it is dispensed, would be treated the same.

B. Is there a shift toward a fee-based model in the provision of retail investment advice?

Based on a 2017 study by the Oxford Economics, the fiduciary rule discourages a commission based brokerage model and drives the trend to fee based payment structures. [35] The same study found that this trend will adversely impact investors because it: (i) decreases firms' and advisors' flexibility to adjust fees; (ii) may lead to increased costs for certain investors; and (iii) may lead to payment structures inconsistent with an investor's payment philosophy.[36] For example, an investor with large assets may be better served by a commission based over a fee based payment structure; particularly if he or she trades infrequently.[37] Further, some investors, may simply prefer transaction-specific fees, verses generalized fees that cover a range of services.[38]

Additionally, there is an apparent contradiction between that reduced flexibility and established regulatory obligations requiring firms and financial advisors to base investment recommendations on a customer's investment profile, which includes the customer's ability to pay related fees.[39] Thus, if a customer's investment profile indicates that a commission based fee structure is preferable over a fee-based payments, advisors and firms require the flexibility to adjust fees accordingly. Any burden on that flexibility, intended or not, is not in investors' best interest.

C. Should the SEC consider acting incrementally?

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[34] *See* Report of Digital Investment Advice (March 2016), available at http://www.finra.org/sites/default/files/digital-investment-advice-report.pdf.
[35] Oxford Economics *supra* note 25 at pp. 8 & 29.
[36] *Id*. at p. 29.
[37] *Id*.
[38] *Id*.
[39] *See, eg*., FINRA Rule 2111, Supp. Material .06, prohibiting "…a [FINRA] member or associated person from recommending a transaction or investment strategy involving a security or securities or the continuing purchase of a security or securities or use of an investment strategy involving a security or securities unless the member or associated person has a reasonable basis to believe that the customer has the financial ability to meet such a commitment."

FSI supports an incremental approach. This approach provides the Commission with the requisite time and opportunity to assess any gaps. It will also help the Commission ensure that any new regulations are specifically tailored to the demonstrated needs of both investors and the market.

D. Who should be considered to be "retail investors?"

FSI believes that the definition of retail investors should include individual investors who are trading for their own accounts, but should exclude certain categories of sophisticated investors, such as those individuals that meet the definition of an accredited investors set forth in Rule 501 of Regulation D.[40]

E. How should the SEC define "investment advice;" should certain activities be expressly excluded from the definition?

Investment advice should be defined to solely pertain to activities that constitute a recommendation or a "call to action" to engage in a specific investment or investment strategy; and should expressly exclude basic financial planning services where no specific personalized advice is given. Any other definition may have the unintended consequence of regulating certain key functions that do not relate to providing individualized advice or services. Some of those functions include: budgeting advice; providing general research literature, general investment and allocation strategies, marketing and education materials that are not customer specific, planning tools and calculators that use customer information but do not recommend specific securities, seminar content, needs analyses, taking and executing unsolicited orders, underwriting efforts that do not include securities recommendations and use of social media. These functions involve incidental or unsolicited services, as well as customer education, guidance and other tools that are essential to producing an informed investing public. These, and other similar activities, should expressly be excluded from the definition of "investment advice."

With respect to the balance of the Commission's questions, FSI looks forward to an ongoing dialogue on these issues, but will generally defer to other commenters in so far as those comments are the best interest of its members and their clients.

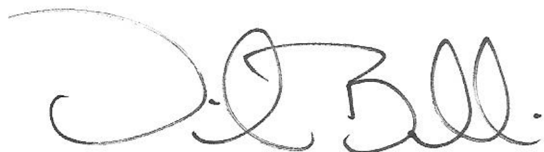
[40] *See* 17 CFR 230.501.

Conclusion

We urge the SEC to take the lead in developing a uniform best interest standard of care applicable to all financial advisors providing personalized investment advice to retail clients. We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the SEC on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at [redacted].

Respectfully submitted,



David T. Bellaire, Esq.
Executive Vice President & General Counsel

Appendix
Sample Short Form Disclosure Document

American Advisors (AA)-Dually Registered Broker-Dealer and Investment Adviser

- AA is obligated by federal securities law to act in the best interest of its customer when providing clients personalized investment advice.
- AA is also obligated to disclose material conflicts of interest that may exist between AA, its financial advisors and their clients. Specifically, AA and its financial advisors may be incentivized to recommend securities transactions or offer investment advice that will maximize the revenue received by the firm or financial advisor. Such incentives could cause the firm or financial advisor to recommend transactions not in the best interest of the client. As a result, AA has developed a comprehensive compliance and supervision system designed to prevent and detect violations of its conflict management policies and procedures. More information concerning these conflicts and conflict management policies can be seen on AA's web site at http://www.aa.com/conflicts_management/.
- As an introducing broker-dealer, our services include taking client orders, executing securities transactions, providing investment research, executing trades and providing custody services. In a brokerage account, clients pay us commissions and applicable fees each time we execute a transaction in your account or perform another service related to the account. This engagement lasts as long as the client wishes to retain the services of AA, and either party may end the relationship at any time subject to the terms of our account agreement.
- As an investment adviser, our services include providing limited term, periodic or ongoing asset monitoring and management. In advisory accounts, fees are either based on an hourly rate, a per project fee or calculated as a percentage of assets under management. This engagement lasts as long as the client wishes to retain the services of AA, and either party may end the relationship at any time subject to the terms of our investment advisory services agreement.
- To engage with AA, clients must provide AA with information regarding the investor's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other relevant information the client may choose to disclose. Clients also must inform AA of any material changes to the above information.
- Clients may research AA and our financial advisors through FINRA's BrokerCheck database at http://www.finra.org/ or the SEC's IARD at http://www.adviserinfo.sec.gov/.
- If you have any questions or concerns about the advice or service you have received, you may contact AA at 555-555-5555 or AA@AAinvestors.com.
- Investors may obtain more detailed information regarding these issues, free of charge at americanadvisors.com. They may also request hard copy of this information free of charge.

SAMPLE