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October 31, 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:

We applaud the Securities and Exchange Commission (SEC) for taking an active role in the debate over the Fiduciary Rule.

The SEC was founded with the goal of protecting ordinary investors.[1] It, inarguably, should play an important role in defining the relationship between advisors and investors.

Until we get more transparency on how the SEC will act, its involvement adds further uncertainty to the ultimate fate of the Fiduciary Rule. This uncertainty, at least In part, is behind many industry groups working hard to delay—or even scrap entirely—its implementation.

In our own conversations with advisors, we hear the same concerns again and again. Advisors are worried about how they will answer questions from regulators if they're asked to provide justification for their investment recommendations. With no clear guidance on how to fulfill the Fiduciary Duty of Care, advisors have no way of knowing whether they could face regulatory penalties or even lawsuits.

The SEC could assuage this uncertainty by more clearly outlining its view of how advisors can fulfill the Fiduciary Duty of Care.

Calm the Markets

In its various FAQs on the Fiduciary Rule, the DOL covered key topics such as conflicts of interest, exemptions, and investor rights. However, the FAQs never addressed the Duty of Care beyond reference to the Prudent Man standard, which states that fiduciaries must act with "care, skill, prudence, and diligence." This standard is far too vague to be of any practical use. It's clear that advisors and investors need more guidance as to what constitutes a fiduciary level of care.

Additional guidance would potentially alleviate significant compliance concerns from advisors and wealth management firms. It would also reassure investors that they are getting proper value for their fees, support the integrity of the markets, and promote the development of more high-quality investment research to better serve advisors and investors.

To the extent we can be helpful, we'd like to share what we've learned on this front from our research and meetings with key constituents across the wealth management space.

Defining Diligent Research

To start, there is absolute agreement that research that meets the fiduciary standard should be 100% un-conflicted and, inarguably, in the best interest of the client. To put a little more meat on that bone, we think truly diligent research should be:

- Comprehensive: Incorporate all relevant publicly available data (e.g. 10-Ks and 10-Qs), including the footnotes and MD&A.

[1] The phrase "protection of investors" appears over 150 times in the Securities Exchange Act of 1934 that established the SEC.

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- Objective: Clients deserve unbiased research.
- Transparent: Client should be able to see how the analysis was performed and the data behind it.
- Relevant: There must be a tangible, quantifiable connection to stock, ETF or mutual-fund performance.

Disclosure Is Not a Substitute for Diligence

The current SEC standards regulating advisors focus heavily on disclosure. Most any potential conflict or deficiency in an advisor's process can be remedied by full disclosure under these guidelines.

While disclosure is important, it's not enough on its own. There was plenty of disclosure revealing the issues with CDO's in the lead up to the financial crisis, but almost no one identified the problem because the information was buried in prospectuses running in the hundreds of pages.

A disclosure-only standard encourages the same sort of issues. Investors shouldn't have to read through long and complicated filings just to confirm that their advisor's investment recommendations are based on research that meets the criteria above.

Diligent Research Is Hard to Find

We freely admit that doing proper diligence is easier said than done. If there were an obvious off-the-shelf source for diligent research, we'd likely not see the pushback we've seen for the new rule.

The SEC's timing for this new rule could not be better considering how hard it is get diligent research today. For starters, there's the declining signal/noise ratio for investment research. Between CNBC, Fox Business News, and a myriad of online and offline publications, there are more opinions and research reports/articles than ever.

Relying on sell-side research can also be risky. While these reports often contain valuable information, the analysts/firms that write them may be compromised in a myriad of ways. If the SEC wants to discourage conflicts of interest (inarguably a problem for the integrity of the investing business), then sell-side research should play a less prominent role in developing and justifying investment recommendations.

Doing diligence oneself is not a reasonable solution for most investors/advisors either. Accounting rules and disclosures have become more complex and financial filings longer than ever. Who has time to read, analyze and model financial data from 10-K and 10-Q reports that are more than 200 pages on average?

Many traditional short-cuts like the P/E ratio and ROE have proven ineffective over time. Investors should also beware of research that claims to offer more sophisticated metrics as it is often plagued by inconsistencies and flawed methodologies.

You Know It When You See It

The lack of a readily apparent solution should not deter the SEC's advocacy for diligent research. We support the SEC's approach to improving investment research thus far. We do not see the need for new rules or regulations, rather enforcement and application of existing rules, like the fiduciary rule, will suffice. All grandstanding aside, who can argue against the merits of more closely aligning the best interests of investors with the wealth management industry?

The SEC need not provide proscriptive details on what diligent research is. We think guidelines like what we propose above will easily suffice.

Investors recognize diligent research when they see it. There are many research firms doing good work and providing diligent research, and our free-market economy will ensure their prosperity as long as diligence remains a priority. When diligent research thrives, so does the integrity and prosperity of the markets.

This article originally published here on <DATE>.

Disclosure: David Trainer and Sam McBride receive no compensation to write about any specific stock, sector, style, or theme.

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To fulfill the Duty of Care, research should be:

1. **Comprehensive** - All relevant publicly-available (e.g. 10-Ks and 10-Qs) information has been diligently reviewed, including footnotes and the management discussion & analysis (MD&A).
2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide tangible, quantifiable correlation to stock, ETF or mutual fund performance.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our robo-analyst technology empowers us to perform for thousands of stocks, ETFs and mutual funds.

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