NATIONAL EMPLOYMENT LAW PROJECT

Christine L. Owens
Executive Director

www.nelp.org

NELP National Office
75 Maiden Lane
Suite 601
New York, NY 10038
212-285-3025

Washington DC Office
2040 S Street NW
Lower Level
Washington, DC 20009
202-640-6520

California Office
2030 Addison Street
Suite 310
Berkeley, CA 94704
510-982-5945

Washington State Office
317 17th Avenue South
Seattle, WA 98144
206-324-4000

October 20, 2017

The Honorable Jay Clayton
Chairman
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

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

Dear Chairman Clayton:

The National Employment Law Project appreciates the opportunity to respond to your request for comment on standards of conduct for investment advisers and broker-dealers.[1] NELP is a non-profit research and policy organization that for more than 45 years has advocated for the employment and labor rights of working families, who count on every dollar of their retirement and non-retirement savings to make ends meet. We also promote policies that help unemployed workers regain their economic footing; these workers may be particularly vulnerable to harm from conflicted investment advice. We urge the Securities and Exchange Commission to strengthen investment protections for working families by developing an effective rule that extends a strong fiduciary best-interest standard to all securities professionals – broker-dealers and investment advisers alike – who provide personalized investment advice to retail customers.

I. Introduction. Retail investors seek advice from broker-dealers and investment advisers to help them manage their finances and plan for their families' financial future. Retail investors – as distinct from institutional investors, professional money managers, and high-net-worth "sophisticated" investors – are by definition individuals who are investing their money for family and household needs.[2] The statutory and regulatory frameworks that govern the advice that these retail customers receive – including the standards of care that apply – vary widely between broker-dealers and investment advisers. Among other differences,

[1] *See* U.S. Securities & Exchange Commission, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers*, https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31 (June 1, 2017) (the "2017 Request for Comment").

[2] Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act defines "retail customer" as "a natural person . . . who (1) receives personalized investment advice about securities from a broker or dealer or investment adviser; and (2) uses such advice primarily for personal, family, or household purposes." Dodd-Frank Wall Street Reform & Consumer Protection Act, at § 913(a), Pub. L. No. 111-203, 124 Stat. 1376, 1824 (July 21, 2010) (the "Dodd-Frank Act"). Our references in this comment letter to "retail customer" or "retail investor" are intended to use the same definition as Section 913 of the Dodd-Frank Act.

investment advisers are fiduciaries who must act in their clients' best interests and are subject to duties of loyalty and care; broker-dealers, by contrast, are generally subject only to a duty of fair dealing, which requires that recommendations be "suitable" for a customer. As the SEC has long acknowledged, retail investors are generally not aware of the different regulatory frameworks that apply among financial services professionals, and are also confused by the different standards of care to which they are entitled when they receive personalized investment advice.[3]

In 2010, through Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress directed the SEC to complete a report within six months that would (a) study the effectiveness of the existing standards of care for broker-dealers and investment advisers when providing advice to retail customers, and (b) make recommendations regarding whether regulatory or other changes were needed in order to strengthen the existing standards of care.[4] Congress also authorized the Commission to promulgate rules establishing a fiduciary duty for brokers and dealers.[5]

In January 2011, after soliciting input and reviewing more than 3,500 comment letters, Commission staff published its *Study on Investment Advisers and Broker-Dealers* (the "2011 IA/BD Report") concluding, among other things, that "despite the extensive regulation of both investment advisers and broker-dealers, retail customers do not understand and are confused by . . . the standards of care applicable to investment advisers and broker-dealers when providing personalized investment advice and recommendations about securities."[6] The report further concluded that the differences between these standards of care, and the confusion regarding which standards apply, ultimately harm retail customers.[7] Commission staff therefore recommended that the Commission develop a uniform fiduciary standard for both investment advisers and broker-dealers that is consistent with the standard that currently applies to investment advisers,[8] explaining that given the risk of harm to investors when making some of the most important decisions in their lives, "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."[9]

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[3] *See, e.g.*, U.S. Securities & Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, at i, 101, 165-66 (Jan. 2011), available at https://www.sec.gov/news/studies/2011/913studyfinal.pdf (the "2011 IA/BD Report"); Angela A. Hung et al., *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*, at xviii-xix, 87-113, RAND Institute for Civil Justice, commissioned by the U.S. Securities & Exchange Commission, at http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf (the "2008 RAND Report").

[4] Dodd-Frank Act §§ 913(b)-(d), 124 Stat. at 1824-27. Of course, the Commission study directed by the Dodd-Frank Act was itself just one step in a much more extensive history regarding the SEC's consideration of the standards of care that apply when broker-dealers and investment advisers provide personalized investment advice to retail investors. *See generally* Letter from Barbara Roper & Micah Hauptman, Consumer Federation of America, to Chairman Jay Clayton, U.S. Securities & Exchange Commission, at 14-20 (Sept. 14, 2017), available at https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2447346-161075.pdf (the "CFA Comment Letter").

[5] *See* Dodd-Frank Act §§ 913(f), (g), 124 Stat. at 1827-29.

[6] 2011 IA/BD Report 101.

[7] *See id.*

[8] *Id.* at v-viii, 101-10.

[9] *Id.* at 101.

Two years later, in March 2013, the Commission sought information from the public relating to the benefits and costs of changing the standards of conduct for broker-dealers when providing personalized investment advice about securities to retail customers.[10] Following these steps, in March 2015, then-Chair Mary Jo White announced that she believed the SEC should act pursuant to its Section 913 authority to implement a fiduciary duty for broker-dealers: "After significant study and consideration, I believe that broker-dealers and investment advisers should be subject to a uniform fiduciary standard of conduct when providing personalized securities advice to retail investors. As set forth in Section 913, the financial professional giving advice to a retail client should be required to provide advice that is in the client's best interests, without regard to the financial or other interests of the financial professional."[11]

The Commission subsequently listed a proposed rulemaking on its Fall 2015 Unified Agenda of Regulatory and Deregulatory Actions, with a projected date of October 2016 to publish an NPRM that would establish a uniform fiduciary standard of conduct for broker-dealers and investment advisers.[12] Consistent with this notice on the regulatory agenda, Chair White testified that same month that SEC staff were developing rulemaking recommendations for the Commission's consideration to implement a uniform fiduciary duty.[13] The notice regarding proposed rulemaking was subsequently deleted from the SEC's semiannual regulatory agenda, and the SEC has to date failed to publish any public proposals.

For at least a decade, then, the SEC has been actively reviewing the standards of conduct applicable to broker-dealers and investment advisers when they provide personalized investment advice to retail customers. Despite this lengthy review and the common themes that have been identified for the Commission – as discussed in our comments below – the Commission has failed to move forward with rulemaking or even a public proposal to strengthen investor protections and harmonize the standards of care between investment advisers and broker-dealers. Instead, the Commission has now published yet another request for comment – an informal, pre-regulatory step – that appears to be the start of yet another round of analysis that may eventually inform rulemaking down the road. Meanwhile, retail investors are being harmed every day by endemic confusion regarding the duties they are owed when they interact with different financial services professionals; weak standards of conduct that govern the provision of personalized investment advice; and lax enforcement of even the weak standards that do exist.

The Department of Labor has, however, taken action. DOL's 2016 Fiduciary Rule addresses these harms within the segments of the financial marketplace for retirement investment advice that

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[10] *See* U.S. Securities & Exchange Commission, Request for Data and Other Information, *Duties of Brokers, Dealers, and Investment Advisers*, 78 Fed. Reg. 14,848 (Mar. 7, 2013), at https://www.sec.gov/rules/other/2013/34-69013.pdf.

[11] *Examining the SEC's Agenda, Operations, and FY 2016 Budget Request: Hearing Before the H. Comm. on Fin. Servs.*, 114th Cong. 77-78 (Mar. 24, 2015) (statement of Mary Jo White, Chair, U.S. Securities & Exchange Commission), available at https://financialservices.house.gov/uploadedfiles/114-10.pdf.

[12] *See* U.S. Securities & Exchange Commission, *Personalized Investment Advice Standard of Conduct*, RIN 3235-AL27, at https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201510&RIN=3235-AL27.

[13] *Examining the SEC's Agenda, Operations, and FY 2017 Budget Request: Hearing Before the H. Comm. on Fin. Servs.*, 114th Cong. 75 (Nov. 18, 2015) (statement of Mary Jo White, Chair, U.S. Securities & Exchange Commission), available at https://financialservices.house.gov/uploadedfiles/114-62.pdf.

are governed by the agency's authority under ERISA.[14] That rule – developed over a six-year period, with two detailed proposals, multiple public hearings, and thousands of substantive public comments – expanded the types of retirement investment advice covered by fiduciary protections, subject to certain exemptions.[15] These exemptions include a new "Best Interest Contract" exemption that allows fiduciaries rendering investment advice to use compensation agreements that would otherwise result in a prohibited transaction (like commissions), so long as advisers and financial institutions agree in a written contract that they will follow basic fiduciary standards and take additional steps to mitigate the impact of conflicts of interest.[16]

As discussed further in this comment letter, these changes – although only partially implemented – have already provided significant gains to retirement investors and spurred helpful innovation in the market for financial products and services, without unduly disrupting the industry. Any SEC rulemaking should therefore take care not to undermine the DOL Fiduciary Rule, but should instead build on DOL's comprehensive analysis by extending uniform fiduciary protections to retail investors when they receive personalized securities advice outside the retirement context.

II. Responses to request for comment. The Commission has asked for information on a series of questions that may "inform the SEC's assessment of possible future actions" regarding the standards of conduct applicable to investment advisers and broker-dealers when they provide investment advice to retail investors, with a focus on identifying new developments since the Commission's last request for input in 2013, and on promoting clarity, consistency, and coordination of oversight and regulation.[17] Our responses to specific questions follow.

1. Investor confusion causes significant harm and cannot be addressed with disclosure and advertising requirements alone. The Commission seeks comment on whether retail investors are confused about the standards of conduct that apply when they are receiving investment advice, and whether disclosure requirements or other steps could address any harms caused by that confusion.[18] Recent analyses confirm both that retail investors remain confused about the roles and duties of different financial services professionals, and that disclosure alone is insufficient to cure this confusion and prevent significant financial harm to investors.

Just last year, the analysis supporting the DOL Fiduciary Rule confirmed that the increased complexity in the financial marketplace for retirement products "sows confusion" among retail investors "and increases the potential for very costly mistakes."[19] Among other concerns, the Department noted that plan participants and IRA owners "are unable to assess the quality of the expert's advice or guard against conflicts of interest," and generally speaking "have no idea how advisers are compensated for selling them products."[20]

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[14] *See generally* U.S. Dep't of Labor, *Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice*, 81 Fed. Reg. 20,946 (Apr. 8, 2016) (the "DOL Fiduciary Rule"); U.S. Dep't of Labor, *Best Interest Contract Exemption*, 81 Fed. Reg. 21,002 (Apr. 8, 2016) (the "BIC Exemption").

[15] DOL Fiduciary Rule, 81 Fed. Reg. at 20,947-20,949.

[16] BIC Exemption, 81 Fed. Reg. at 21,003.

[17] 2017 Request for Comment.

[18] *See id.* at Question 1.

[19] DOL Fiduciary Rule, 81 Fed. Reg. at 20,949.

[20] *Id.*

The regulatory impact analysis that accompanied the DOL Fiduciary Rule – a detailed economic assessment of current market conditions and the likely impact of regulatory changes – determined based on its review of the most up-to-date research that "most individuals cannot distinguish between the different types of advisers or the different standards of conduct to which different advisers must adhere, and this confusion is exacerbated by industry marketing and other practices . . . ."[21] The DOL Regulatory Impact Analysis further explained that "[i]nvestors have a difficult time understanding whether their adviser is acting as a broker-dealer or as an RIA [registered investment adviser], and generally do not know which regulatory regime applies or how the regulatory standards differ between regimes."[22]

The Consumer Financial Protection Bureau has also examined this question, and concluded in a 2013 report that investors are unable to distinguish between different advice providers, not least due to the proliferation of – and minimal regulation regarding – the titles and designations that may be used by different financial service providers.[23] The CFPB's analysis determined that "[m]any consumers assume, incorrectly, that financial advisers have a uniform legal duty to make recommendations or sell products that are in the client's best interest."[24]

A long list of recent studies from independent researchers and the financial services industry itself confirms that investors do not understand the different functions broker-dealers and investment advisers perform, and are just as unaware of the different legal obligations that apply. A 2015 RAND study demonstrated that only 3% of survey respondents were able to identify the types of financial services professional required to act in their clients' best interests.[25] A 2017 report by the financial advising and wealth management firm Personal Capital found that nearly half – 46 percent – of Americans incorrectly believe all financial advisors are required to act in their clients' best interests, and another 31 percent were unsure; leading Personal Capital to conclude that "When queried about their knowledge regarding fiduciary duty . . . , Americans are painfully unaware."[26] As Morningstar has explained to the Commission, "even among experienced investors who hold investments outside of retirement accounts, most investors do not understand the distinctions between broker-dealers and Registered Investment Advisors and the conflicts of interest some financial advisors may have when recommending investments."[27]

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[21] U.S. Dep't of Labor, *Regulating Advice Markets: Definition of the Term "Fiduciary"; Conflicts of Interest – Retirement Investment Advice; Regulatory Impact Analysis for Final Rule and Exemptions* 108 (Apr. 2016), at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf (the "DOL Regulatory Impact Analysis").

[22] *Id.* at 135-36; *see also id.* at 143-44.

[23] *See* Consumer Financial Protection Bureau, *Senior Designations for Financial Advisers: Reducing Consumer Confusion and Risks* 7-8, 23-32 (Apr. 18, 2013), at http://files.consumerfinance.gov/f/201304_CFPB_OlderAmericans_Report.pdf

[24] *Id.* at 31.

[25] *See* Jeremy Burke & Angela A. Hung, *Trust and Financial Advice* 14 (Jan. 2015), at https://www.rand.org/content/dam/rand/pubs/working_papers/WR1000/WR1075/RAND_WR1075.pdf.

[26] 2017 Personal Capital Financial Trust Report 5, at https://www.personalcapital.com/assets/email/2017-Personal-Capital-Financial-Trust-Report.pdf.

[27] Letter from Aron Szapiro, Morningstar Inc., to Chairman Jay Clayton, U.S. Securities & Exchange Commission, at 1 (Sept. 7, 2017), available at https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2433284-161040.pdf (the "Morningstar Comment Letter").

The evidence equally strongly supports the conclusion that retail investors' lack of awareness of the standards that apply when they seek personalized investment advice is not curable through stricter disclosure obligations on advice providers. The DOL Regulatory Impact Analysis explains in detail that "available academic and empirical evidence strongly suggest that disclosure alone will be ineffective at mitigating conflicts in financial advice."[28] The data show that many investors ignore disclosures or lack the financial sophistication to understand them; and that even sophisticated, attentive investors would have no clear basis for translating any disclosures into an understanding of whether and how a conflict of interest has affected the advice they received.[29]

Worse, there is evidence that disclosure of conflicts can have negative, unintended consequences; advisers may treat disclosures as obviating any need to mitigate conflicted advice at all, and investors may mistakenly treat the disclosure as a sign of honesty and fail to adjust for possible bias.[30] For these and other reasons, the DOL Fiduciary Rule concluded that "[d]isclosure alone has proven ineffective to mitigate conflicts in advice. . . . The same gap in expertise that makes investment advice necessary and important frequently also prevents investors from recognizing bad advice or understanding advisers' disclosures."[31]

Numerous industry commenters agree that disclosure alone cannot sufficiently protect investors from receiving conflicted advice. TIAA has advised the Commission that "investors do not consistently appreciate and understand the distinctions between the suitability standard to which broker-dealers are presently subject and the securities-law fiduciary standard to which [investment advisers] are subject – and this investor confusion is not sufficiently addressed by the current disclosure regime."[32] And Morningstar commented that "investors' confusion about standards of conduct applicable to different kinds of relationships is likely to continue for some time, and disclosures alone will not clarify those standards for many investors."[33]

Although the Commission's 2017 Request for Information is focused on identifying new information since the SEC's last request for information in 2013, it is worth noting that these recent analyses simply confirm what the SEC has long known, as reflected in its own previous analyses and commissioned studies. The 2008 RAND Report concluded that most retail investors "do not have a clear understanding of the boundaries between investment advisers and broker-dealers. Even those who have employed financial professionals for years are often confused about job titles, types of firms with which they are associated, and the payments they make for their services."[34] And the 2011 IA/BD Report determined that "retail customers do not understand and are confused by the roles played by investment advisers and broker-dealers, and more importantly, the standards of care applicable to investment advisers and broker-dealers when providing personalized investment

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[28] DOL Regulatory Impact Analysis 268; *see also id.* at 135-36, 143-44, 268-71.

[29] *See id.* at 136.

[30] *See id.* at 269-70.

[31] DOL Fiduciary Rule, 81 Fed. Reg. at 20,950-20,951.

[32] Letter from Derek B. Dorn, TIAA, to Chairman Jay Clayton, U.S. Securities & Exchange Commission, at 3 (Sept. 26, 2017), available at https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2597428-161097.pdf (the "TIAA Comment Letter").

[33] Morningstar Comment Letter at 1.

[34] 2008 RAND Report 87.

advice and recommendations about securities."[35] These studies were equally clear that disclosure was not a sufficient cure: "Even after being presented with fact sheets, participants were confused by the different titles. . . . Some participants said they knew which type of investment professional they have, but most did not."[36]

Any new rulemaking by the Commission that fails to account for this long-established consensus, or that purports to address conflicts of interest through disclosure requirements alone, would therefore be extremely difficult to justify and defend.

2. Any observed trend away from commission-based brokerage models and toward fee-based advisory models is likely the result of industry factors unrelated to federal regulation; and in any event is unlikely to harm retail investors in the availability, quality, or cost of advice and services. The Commission seeks comment on whether there has been a trend in the provision of retail investment advice toward a fee-based advisory model and away from commission-based brokerage models; and if so, what the consequences of any such trend may be for retail investors.[37] There is no evidence that any shift toward fee-based advisory models is harming retail investors. To the contrary, investors are likely to benefit from both higher quality and less conflicted investment advice.

A number of industry opponents of heightened standards of care have expressed concern that the DOL Fiduciary Rule has compelled a shift from commission accounts to fee accounts, with purported harms to consumers in the form of higher costs and less choice. The evidence of such a shift is to this point largely anecdotal, and appears to be a broader industry trend that predated the DOL rule rather than resulting from regulation. Morningstar has characterized the shift to fee accounts as "an ongoing trend,"[38] and other industry participants have described this development as one that predates the DOL Fiduciary Rule.[39]

These industry observations are consistent with the analysis of this question in the DOL Regulatory Impact Analysis, which concluded after thorough review that in the market for retirement products, there was likely to be "little conversion of brokerage accounts to fee-based advisory accounts" caused by the DOL Fiduciary Rule.[40] The Department based this conclusion on the availability of the Best Interest Contract Exemption and other vehicles through which fiduciaries could continue to receive commissions, subject to conditions that provide appropriate investor protections; and on the numerous additional exemptions available through the existing rules.[41]

In any event, there is no basis to conclude that a shift from commission-based to fee-based models would harm retail investors, either through higher costs or reduced choice; indeed,

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[35] 2011 IA/BD Report 165.

[36] 2008 RAND Report 111.

[37] *See* 2017 Request for Comment, at Question 4.

[38] Morningstar Comment Letter at 4-5.

[39] *See* CFA Comment Letter at 51. To the extent the DOL Fiduciary Rule has affected this dynamic, industry participants and observers generally agree that it has been to facilitate, not to compel, this trend. *See, e.g.*, Morningstar Comment Letter at 4; Letter from Barbara Novick & Nicole Rosser, BlackRock, to Chairman Jay Clayton, U.S. Securities & Exchange Commission, at 2 (Aug. 7, 2017), available at https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2189134-160256.pdf.

[40] DOL Regulatory Impact Analysis 242-43.

[41] *See id.*

evidence suggests that such a shift would be in their best interests. The data clearly show that conflicted advice – including from commission-based models that give advisers an incentive to make recommendations that earn them the greatest compensation rather than earn investors the best return – tends to be bad advice: the White House Council of Economic Advisers concluded in 2015 that the research "consistently finds that funds characterized by conflicted payments significantly underperform funds sold directly to savers," and that "it is not merely the cost of paying those intermediaries that leads to underperformance."[42] Any shift toward advisory fee accounts or other non-conflicted channels is therefore likely to result in retail investors generating higher returns from better investment products. To the extent that some conflicted investment vehicles become unavailable, investors clearly will not be harmed – they were unlikely to benefit from products that were not in their best interests to begin with.

In addition, DOL's regulatory regime is designed to ensure that any shift to a fee-based model would only occur if it is in the best interests of retail investors. The DOL Fiduciary Rule makes clear that a recommendation to move from a commission-based account to an advisory fee account would itself be fiduciary investment advice, and therefore must itself be in the investor's best interest.[43] In the event that a particular commission-based model does in fact serve a retail investor's best interest, the adviser not only is not compelled to switch to a fee-based model, but would in fact have to comply with applicable prohibited transaction rules in recommending such a change.[44] Moreover, the Department of Labor's rulemaking requires that any fees be reasonable in light of services offered, providing an additional protection against over-charging in fee and commission accounts alike.[45]

For these reasons, many market observers believe a shift toward fee accounts will benefit investors. Morningstar has described the broader trend toward a fee-based model as "largely good for investors," noting that fee-based arrangements "largely reduce conflicts of interest because they remove incentives for advisors to favor particular investments simply because the advisor will receive a larger commission and not because it's a better quality investment."[46] Morningstar has further explained that fee arrangements will likely increase the quality of advice given to retail investors because "with greater transparency, advisors will need to offer advice commensurate with the fees they charge."[47]

In other words – even if action by the Commission to establish an enforceable best-interest standard for brokers and dealers did accelerate an existing trend from commission-based to fee-based models, the available evidence makes clear that this shift would benefit retail investors by reducing conflicts and removing harmful investment products from the market. To the extent that some brokerage firms attempt to exploit the DOL Fiduciary Rule to justify a shift to fee accounts on terms that are not in investors' best interests, the rule provides DOL with the regulatory and

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[42] White House Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings* 10-11 (Feb. 2015), at https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf (the "2015 CEA Report").

[43] *See* DOL Fiduciary Rule, 81 Fed. Reg. at 20,966-20,967, 20,992; DOL Regulatory Impact Analysis 242-43.

[44] DOL Fiduciary Rule, 81 Fed. Reg. at 20,992.

[45] *See* BIC Exemption, 81 Fed. Reg. at 21,003, 21,007 & n.11, 21,026, 21,029-21,031; *see also* DOL Fiduciary Rule, 81 Fed. Reg. at 20,947.

[46] *See* Morningstar Comment Letter at 4-5.

[47] *Id.* at 5.

enforcement tools necessary to protect against any such harmful impact; revised SEC standards of conduct could be designed to address any similar concerns.

3. Partial implementation of the Labor Department's Fiduciary Rule has so far led to significant investor gains and beneficial product innovation in the marketplace, without unduly disrupting the industry. The Commission seeks input regarding the experience of retail investors and market participants under the DOL Fiduciary Rule, which has now been partially implemented.[48] The early evidence is that the DOL Fiduciary Rule is already benefiting investors, without imposing unreasonable compliance burdens on financial firms.

Beginning in June 2017, financial institutions and advisers covered by the DOL Final Rule generally were required to (a) make recommendations that are in their client's best interest, (b) avoid misleading statements, and (c) charge no more than reasonable compensation for their services.[49] Implementation of these requirements has already led to significant gains for retirement investors by reducing harmful conflicts of interest in the advice they receive. According to the Labor Department's 2017 estimates, the partial implementation that has already occurred is likely to provide a "significant portion" of the estimated $33 to $36 billion in potential gains to IRA investors over the first ten years, for just one segment of the market.[50]

In addition, implementation of the DOL Fiduciary Rule has prompted innovation in the financial services industry through the development of new share classes that reduce conflicted advice, minimize costs, improve outcomes, and enhance transparency for retail investors. As just one example, "clean shares" – a new class of mutual fund shares designed to include fees only for fund management, not for distribution – were approved by the SEC earlier this year.[51] These shares are already being offered by several mutual funds, with many more reportedly planning to follow.[52] By eliminating all indirect third-party payments and charging investors only for direct fund management costs, clean shares have the potential to reduce conflicts and benefit investors by improving investment outcomes.[53]

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[48] *See* 2017 Request for Comment, at Question 5.

[49] *See* U.S. Dep't of Labor, Notice of Proposed Rulemaking, *Extension of Transition Period and Delay of Applicability Dates*, 82 Fed. Reg. 41,365, 41,372 (Aug. 31, 2017). Remaining provisions of the DOL Final Rule and related exemptions are currently scheduled for applicability on January 1, 2018, although the Department recently published a Notice of Proposed Rulemaking to further extend this applicability date for an additional 18 months. *See id.* at 41,371.

[50] *Id.* at 41,372.

[51] *See* Division of Investment Management, U.S. Securities & Exchange Commission, No-Action Letter to Capital Group Companies, Inc. Regarding "Clean Shares" (Jan. 11, 2017), at https://www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d.htm.

[52] *See, e.g.*, Daisy Maxey, *PNC, in Fiduciary Move, Offers "Clean" Mutual Fund Shares*, Wall St. J. (June 9, 2017) ("Such lower cost shares are now being launched by many fund companies in part to help advisers and brokers comply with the [Labor Department's] new retirement-savings rule, which is aimed at curbing conflicted advice on retirement accounts.").

[53] *See* Aron Szapiro & Paul Ellenbogen, *Early Evidence on the Department of Labor Conflict of Interest Rule: New Share Classes Should Reduce Conflicted Advice, Likely Improving Outcomes for Investors* 6-9 (Apr. 2017), at https://corporate1.morningstar.com/ResearchLibrary/DownloadRPSpdf.aspx?url=http://rps.morningstar.com/api/v2/654566632/documents/802119/file.

These benefits have accrued without undue disruption to the industry. To the contrary, financial services companies have reported that they were well-prepared for implementation of the DOL Fiduciary Rule, and that compliance has not been overly burdensome.[54]

Apart from the implementation experience to date, the SEC also seeks input on "other ways in which the Commission should take into account the Department of Labor's Fiduciary Rule in any potential actions."[55] In considering its own regulatory next steps, the Commission should take into account DOL's comprehensive process and should harmonize the Commission's own approach to the DOL standard, rather than seeking to undermine or replace it.

The DOL Fiduciary Rule was the product of a six-year rulemaking process that began when the Department first proposed to amend its fiduciary definition in 2010.[56] The Department reviewed more than 360 comments on that proposal and held two days of public hearings, ultimately deciding – in light of questions and comments that were raised during that process – to take additional time for review and to issue a new proposed rulemaking.[57] The Department published a second notice of proposed rulemaking with accompanying exemptions and preliminary regulatory impact analysis in 2015, and received more than three thousand substantive comment letters on those proposals; the Department also held four days of public hearings (at which 75 speakers testified), and conducted hundreds of meetings with stakeholders including consumer groups, financial firms, trade associations, elected officials, and others.[58] In addition, the Department consulted extensively with other federal agencies and regulators, including the SEC, Treasury Department, Commodity Futures Trading Commission, North American Securities Administrators Association, and Financial Industry Regulatory Authority (FINRA).[59]

The Commission notes in connection with its Request for Comment that it "welcome[s] the Department of Labor's invitation to engage constructively as the Commission moves forward with its examination" of broker-dealer and investment adviser standards of conduct.[60] Constructive engagement would of course not be a new development: the Department of Labor in fact undertook detailed and extensive coordination with Commission staff in developing its proposed and final rules, as reflected in the dozens of interagency staff meetings and thousands of pages of documents exchanged over a five-year period that spanned the tenure of three SEC Chairs.[61]

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[54] *See* Letter from Sen. Elizabeth Warren to Sec'y Alexander Acosta, U.S. Dep't of Labor, at 2-5 (Sept. 5, 2017), at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA27/00015.pdf (citing post-implementation earnings calls with several dozen financial services companies).

[55] 2017 Request for Information.

[56] *See* DOL Fiduciary Rule, 81 Fed. Reg. at 20,956.

[57] *Id.* at 20,957.

[58] *Id.* at 20,958.

[59] *See id.* at 20,958-20,960.

[60] 2017 Request for Comment.

[61] *See, e.g.*, *Examining the SEC's Agenda, Operations, and FY 2016 Budget Request: Hearing Before the H. Comm. on Fin. Servs.*, 114th Cong. 33, 40-41, 49-50 (Mar. 24, 2015) (testimony of Mary Jo White, Chair, U.S. Securities & Exchange Commission), at https://financialservices.house.gov/uploadedfiles/114-10.pdf; *see also* Letter from Mary Jo White, Chair, U.S. Securities & Exchange Commission, to Sen. Ron Johnson, Chair, S. Comm. on Homeland Sec. & Gov't Affairs (May 5, 2015) ("At DOL's request, Commission staff provided technical assistance in connection with DOL's [fiduciary] rule proposal. Specifically, Commission staff had conference calls and in-person meetings with staff from DOL, during which Commission staff shared their expertise regarding the Commissions' regulation of investment advisers and broker-dealers, including disclosure requirements and the Commission's

The thoroughness of the Department's comprehensive analysis is good reason for the Commission to model its own approach on the Department's overall framework when addressing the divergent standards of conduct that apply to broker-dealers and investment advisers. As noted in a recent comment letter to the Commission from Vanguard – which "support[s] the Department's updated definition of fiduciary advice for the modern retirement marketplace" – there is "little justification for considering a suitability standard sufficient for investment recommendations made by broker-dealers" when "investment advisers and now retirement advisers are both subject to a best interest standard."[62]

An additional factor relating to the DOL Fiduciary Rule that the Commission should consider is that the Department's decisions this year to extend repeatedly the applicability dates for parts of the DOL Fiduciary Rule and exemptions – combined with the Commission's inaction when it comes to the standards that apply to broker-dealers providing personalized investment advice – are leading states to enact or consider enacting their own state-level fiduciary rules.[63] It is understandable that states would seek to protect their residents, working families, and retirees in the absence of a reliable, nationally-uniform best interest standard; and in the interest of establishing such a standard, the Commission should act quickly to establish a uniform fiduciary duty for broker-dealers and investment advisers alike.[64] As Vanguard recently explained, the risk if the Commission does not establish a best-interest standard for broker-dealers is that "retail investors may be required to navigate unique standards that differ at both the federal and state levels," whereas "prompt action by the Commission" to establish a best-interest standard, when combined with close regulatory coordination, "can ensure that services are rendered pursuant to duties that are consistent across the retail investing landscape."[65]

4. The different standards of conduct that currently apply to different accounts can result in investor confusion that leads to financial harm. The Commission seeks comment on the benefits and costs of having multiple standards of conduct that apply between those accounts that are, and are not, subject to the Labor Department's Fiduciary Rule; and between personalized securities advice that retail investors receive when provided by broker-dealers as compared to investment advisers.[66]

As noted in our response to Question 1 above, one consequence of the varying standards of conduct that apply to different advice providers and different investment settings is that consumers

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approach to conflicts; the regulatory framework applicable to broker-dealers and investment advisers; and the potential impact of DOL's rule proposal on retail investors and the markets.").

[62] *See* Letter from F. William McNabb III, Chairman & CEO, The Vanguard Group, Inc., to Chairman Jay Clayton, U.S. Securities & Exchange Commission, at 3 (Sept. 29, 2017), at https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2614762-161147.pdf (the "Vanguard Comment Letter").

[63] *See* Nev. Rev. Stat. Ann. § 628A.010 (June 2, 2017); *see also* Michael Thrasher, *Other States Considering Their Own "Fiduciary Rules" After Nevada's Becomes Law*, WealthManagement.com (June 26, 2017), at http://www.wealthmanagement.com/industry/other-states-considering-their-own-fiduciary-rules-after-nevada-s-becomes-law (quoting the state legislative sponsor of a Nevada fiduciary-duty law as deciding to pursue the state-level approach because of uncertainty caused by delays in the full implementation of the DOL Fiduciary Rule); Lisa Beilfuss, *States to Trump: Leave Retirement Rule Intact or We'll Act*, Wall St. J. (Sept. 12, 2017), https://www.wsj.com/articles/states-to-trump-leave-retirement-rule-intact-or-well-act-1505208600.

[64] NELP supports state efforts to strengthen standards of care in the absence of federal leadership, but continues to believe that a nationally-uniform floor below which states cannot weaken fiduciary standards of care is necessary.

[65] Vanguard Comment Letter at 3, 7.

[66] *See* 2017 Request for Comment, at Question 6.

are generally unaware of the obligations they are owed by financial service professionals. The investor confusion that results is damaging not in the abstract, but precisely because it leads to investor harm. Many investors incorrectly believe that all advice providers are in fact required to act in their clients' best interests, which means investors are more likely to assume – or be misled into believing – that a professional's self-interested sales recommendations are instead fiduciary advice.[67] The harm that results is tremendous: the costs of this erroneous assumption have been quantified at between $95 and $189 billion over the next ten years, in the mutual fund segment for IRA investors alone.[68]

The appropriate solution is to strengthen the SEC's protections for retail investors in non-retirement accounts to match the standards that now apply to retirement accounts under the DOL Fiduciary Rule. As TIAA commented, "because distinctions between the standards of conduct that apply to RIAs and broker-dealers are largely lost on investors, perpetuating those distinctions is not in investors' best interests."[69] And especially because retail investors mistakenly believe at present that they are already receiving fiduciary advice, it would make no sense to harmonize the current standards of conduct by reducing all standards to the lowest common denominator; doing so would compound the harm caused by investors' mistaken belief that advice providers are generally required to protect their clients' interests. Instead, as the Commission's own staff recommended more than six years ago, the Commission should apply a best interest standard of conduct to personalized investment advice provided to retail investors, whether by a broker-dealer or an investment adviser.[70]

5. Because disclosure-based approaches will not meaningfully curb the harm to retail investors caused by conflicts of interest, the Commission should instead implement a uniform best-interest standard that applies to broker-dealers and investment advisers alike. The Commission seeks input on what disclosure-based approaches it should consider, what standards-of-conduct approaches it should consider, and whether the standards between broker-dealers and investment-advisers should be the same.[71]

As noted in our response above to the Commission's separate questions on disclosure-based efforts to mitigate harm to retail investors, the evidence overwhelmingly demonstrates that disclosure-based approaches alone do not meaningfully allow retail investors to avoid costly conflicts of interest when they seek or receive individualized investment advice. For this reason, the Commission should not proceed with a disclosure-only approach.

Instead, the Commission should – as contemplated by the Dodd-Frank Act, and as already recommended by Commission staff – regulate a uniform best-interest standard for broker-dealers. Specifically, the Commission should:

- establish a uniform fiduciary standard for broker-dealers and investment advisers that requires them to act in the best interest of retail investors, including an obligation to identify and recommend the best available investment option for each customer without regard to financial or other interests of the professional;

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[67] *See* 2011 IA/BD Report 98.

[68] DOL Regulatory Impact Analysis 158; *see also* 2015 CEA Report 2, 20-21 (estimating an aggregate annual cost to retirement savers of $17 billion).

[69] TIAA Comment Letter, at 4.

[70] *See* 2011 IA/BD Report 101.

[71] *See* 2017 Request for Comment, at Question 8.

- prohibit conflict-inherent practices that presumptively undermine the professional's ability to provide advice in their clients' best interest, and require the disclosure and appropriate management of remaining material conflicts;
- broadly define the term "recommendation" to provide expansive coverage of the fiduciary standard to broker-dealer interactions with retail investors; and
- ensure that the fiduciary standard is privately enforceable by retail investors, with no requirement to arbitrate disagreements unless the investor elects to do so.

In order to address the harm caused to investors by the current framework of non-overlapping standards, we recommend that a revised fiduciary standard apply uniformly to broker-dealers and investment advisers alike.

6. Private enforceability of broker-dealer and investment adviser standards of conduct is a critical element to achieving compliance with any new standards. The Commission seeks comment on how any new requirements should be enforced, including whether private remedies should be available.[72] Given the insufficiency of the Commission's examination and enforcement resources to secure compliance with even the current standards, retail investors should have a private right of action to enforce any new standards of conduct.

At present, the Commission does not generally examine broker-dealers on a routine basis; instead, primary responsibility for broker-dealer examination rests with FINRA, a self-regulatory organization (SRO) for broker-dealers.[73] FINRA's current practice is to conduct an onsite routine or "cycle" examination at intervals ranging from every one to every four years, depending on a FINRA-developed risk profile,[74] and to conduct "cause" or targeted examinations when indicated by complaints or other specific information.[75] The Commission also has statutory authority under the federal securities laws to investigate violations of the federal securities laws and SRO rules, but does not examine broker-dealers on a routine basis and does not have the resources to do so.[76]

The predictable under-enforcement caused by this combination of factors – vesting primary oversight in an industry-controlled self-regulatory model, with minimal and resource-constrained backup enforcement efforts by the Commission – is illustrated by the striking rate at which deficiencies are identified: in recent years, fully *94 percent* of SEC broker-dealer examinations conclude with a deficiency letter that requests corrective action.[77] And the violation rate identified by FINRA's own "cycle" exams – which are simply routine examinations not based on any specific complaint – typically approaches 50 percent.[78] In other words, even the current extremely lax requirements for broker-dealers are honored largely in the breach, and both FINRA and the Commission are failing to hold broker-dealers accountable to the minimal suitability standard and other requirements.

Private enforceability of any new standards of conduct for broker-dealers will therefore be necessary to make those standards meaningful. In concluding that private enforcement was a

[72] *See* 2017 Request for Comment, at Question 11.

[73] *See* 2011 IA/BD Report at iv.

[74] *See id.* at A-9 & nn.26-28.

[75] *See id.* at A-11.

[76] *See id.* at v, A-13 to A-14.

[77] *See id.* at A-15.

[78] *See, e.g.*, *id.* at A-11 (noting that FINRA conducted 2,151 cycle exams in 2010, and that 1,064 of those exams resulted in disciplinary action).

necessary element of its own regulatory framework, including the BIC Exemption, the Department of Labor explained that the alternative would not sufficiently promote compliance by financial institutions and advisers with their obligations: "The exemption's enforceability, and the potential for liability, are critical to ensuring adherence to the exemption's stringent standards and protections, notwithstanding the competing pull of the conflicts of interest associated with the covered compensation structures."[79] The Department reasoned that "[t]he existence of enforceable rights and remedies gives Financial Institutions and Advisers a powerful incentive to comply with the exemption's standards, implement policies and procedures that are more than window-dressing, and carefully police conflicts of interest to ensure that the conflicts of interest do not taint the advice."[80]

Many financial professionals agree. The Financial Planning Coalition – comprised of the Certified Financial Planner Board of Standards as well as several membership organizations representing tens of thousands of financial planners and financial planning advisors – has similarly taken the position that private enforceability is a necessary element of a best interest standard because it provides "much-needed teeth" to the standard.[81] In opposing a proposed delay of the private enforcement mechanism under part of the DOL Fiduciary Rule, the Financial Planning Coalition recently explained that without private enforcement rights, "consumers do not have access to legally binding contracts on which they can rely to uphold their right to conflict-free advice in their best interest."[82] Private enforceability is therefore a critical element of any effort by the Commission to establish a uniform best-interest standard for broker-dealers and investment advisers.

III. Conclusion. The Commission has the opportunity to close a longstanding gap in the regulatory framework that governs securities professionals who provide personalized investment advice to retail investors. Implementing an enforceable fiduciary standard for broker-dealers would reflect economic and marketplace realities, protect investors from harmful conflicts of interest, align with the well-supported DOL Fiduciary Rule, and prove eminently manageable for the financial services industry.

On behalf of working families who depend on receiving fair investment advice to protect their hard-earned savings, we urge the Commission to implement a strong, uniform fiduciary rule as promptly as possible. Please contact Judith M. Conti at [redacted] if you have questions about these comments.

Sincerely,

Christine L. Owens

Christine L. Owens
Executive Director

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[79] BIC Exemption, 81 Fed. Reg. at 21,021.

[80] *Id.* at 21,008; *see also id.* at 21,033.

[81] Letter from Financial Planning Coalition to U.S. Department of Labor, at 4 (Sept. 15, 2017), available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA27/00078.pdf.

[82] *Id.*