LPL Financial

February 22, 2018

Via Electronic Submission

Chairman Jay Clayton
U.S. Securities and Exchange Commission
100 First Street NE
Washington, D.C. 20210

RE: Standard of Conduct for Advisory and Brokerage Accounts

Dear Chairman Clayton:

LPL Financial LLC ("LPL") appreciates the opportunity to respond to the U.S. Securities and Exchange Commission's (the "Commission") solicitation of public comments on the standards of conduct applicable to investment advisers and broker-dealers. LPL is one of the country's largest independent broker-dealer firms, and provides brokerage and advisory services to over 15,000 financial advisors and over 700 diverse financial institutions. LPL further serves as a trusted partner to many of the country's retirement plans and market participants for technology, custodial, and consulting services.

As the Commission knows, there has been a vigorous public discussion regarding what standards should apply when a financial institution or professional provides investment advice or recommendations to a retail investor, most recently in connection with the Department of Labor's Fiduciary Rule. Throughout this debate, LPL has voiced its strong support for standards that will protect investors by helping to ensure that they receive investment advice and recommendations that are fair and appropriate for their particular investment, savings and financial needs.[1] We also think it is important that financial institutions and professionals provide clear disclosures regarding the nature of their services, their fees and compensation, and material conflicts of interest so that investors can make informed choices about investment services and products.

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[1] Letter from David P. Bergers, General Counsel, LPL Financial to U.S. Dep't of Labor (March 17, 2015) (addressing Proposed Extension of Fiduciary Rule Applicability Date); Letter from David P. Bergers, General Counsel, LPL Financial to U.S. Dep't of Labor (Jul. 21, 2015) (addressing Proposed Definition of the Term "Fiduciary" and Related Proposed Prohibited Transaction Exemptions); Letter from Stephanie L. Brown, Managing Director, General Counsel, LPL Financial to Elizabeth M. Murphy, Sec.'y, U.S. Sec. and Exch. Comm'n (Aug. 30, 2010) (addressing comments on File No. 4-606: Study Regarding Obligations of Brokers, Dealers, and Investment Advisers).

At the same time, we have urged that such standards and requirements be adopted in a way that preserves investor choice and access to a wide range of investment and financial services. We are further concerned that broker-dealers and investment advisers are beginning to face divergent standards under various regulatory regimes, including not only from federal regulators like the Department of Labor and the Commission, but also from the 50 states.[2] We believe it is critical that the Commission move forward with its own standard of conduct. Doing so will harmonize these standards, reduce investor confusion and costs, facilitate compliance, and promote holistic investment services, advice and planning that will result in better savings and investment outcomes for all Americans, regardless of whether they are saving through a tax-qualified retirement account or a taxable account, and regardless of whether they receive advice from a broker-dealer or an investment adviser.

As such, we applaud the Commission's efforts to consider, and seek industry perspectives on, adopting a standard of conduct that more broadly protects and serves the interests of all retail investors. As the prudential regulator for broker-dealers and investment advisers, the Commission is best positioned to engineer such a comprehensive rule. Adopting a harmonized standard of conduct for retail accounts is an important exercise of the Commission's core mission and scope of authority. Further, the Commission has the mechanisms to both adopt and enforce such a standard of conduct, and a clear interest in protecting all retail investors.[3] We are pleased to present our proposal for a standard of conduct that we believe will protect retail investors while preserving investor choice and access.

I. Proposed Elements of a Standard of Conduct for Registered Investment Advisers and Broker-Dealers

LPL strongly supports the Commission's consideration of a standard of conduct for retail accounts that is, as you have advocated, "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] and state insurance regulators."[4] As explained in more detail below, we believe the standard of conduct should be based on the core principles that

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2 In addition to the Department of Labor, a number of states have adopted or are presently considering legislation that imposes general fiduciary obligations upon investment activities or require disclosures for non-fiduciary investment recommendation and financial planning relationships. *See, e.g.,* Act Protecting the Interests of Consumers Doing Business with Financial Planners, 2017 Conn. Legis. Serv. P.A.17-120 (H.B. 6992) (enacted July 5, 2017); Financial Planners – Investments – Fiduciary Duties, 2017 Nevada Laws Ch. 322 (S.B. 383) (enacted July 1, 2017); 2017 New York Assembly Bill 2464 (introduced Jan. 20, 2017) (relating to mandating greater levels of disclosure by non-fiduciaries that provide investment advice); 2018 New Jersey Senate S735 (introduced Jan. 12, 2018) (requiring certain disclosures by non-fiduciary investment advisers).

3 Indeed, the Commission's 2011 study of the effectiveness of existing standards of care for broker-dealers and investment advisers, required by Section 913 of the Dodd-Frank Act, concluded that the Commission should establish a standard of conduct based on the duties of loyalty and care, and that harmonization of regulation would heighten investor protection, preserve investor choice, and encourage the delivery of advice that is in investors' best interests. Staff of the U.S. Securities and 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 (January 2011) ("Commission Study on Uniform Fiduciary Standard").

4 Chairman Jay Clayton, Testimony on "Oversight of the U.S. Securities and Exchange Commission," United States Senate Committee on Banking, Housing and Urban Affairs (Sept. 26, 2017).

are rooted in the common law of trusts, including the duty of prudence, the duty of loyalty, and the duty to provide full and fair disclosure regarding services, fees, compensation and material conflicts of interest. A principles-based standard based on these elements would clarify and enhance the standards and protections already in place under the regulatory regimes that apply to investment advisers under the Investment Advisers Act of 1940 ("Advisers Act") and to broker-dealers under the Securities Exchange Act of 1934 and under FINRA regulations, and be consistent with the regulatory regime governing retirement assets under ERISA and the Fiduciary Rule.[5] We also believe that a standard of conduct built on these principles would strengthen the control framework governing the provision of retail investment advice as a whole – whether episodic or ongoing – while continuing to promote flexibility and innovation in the services provided to retail investors.

1. ***Registered investment advisers and broker-dealers should provide advice that is prudent and based on the investor's investment objectives, risk tolerance and financial needs.*** Under the common law of trusts, the duty of prudence requires trustees to exercise reasonable care, skill, and caution by considering the circumstances, objectives, and plan of administration of the trust whose assets the trustee has been entrusted with.[6] Similarly, under ERISA, the duty of prudence requires fiduciaries to act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person "acting in a like capacity and familiar with such matters would use," and based on the investment objectives, risk tolerance, financial circumstances and needs of the investor.[7]

   The obligation to provide prudent investment advice that is appropriate for an investor's circumstances is a principal component of the suitability obligations under the FINRA Rules and the Advisers Act. The Supreme Court has interpreted Sections 206(1) and (2) of the Advisers Act as establishing a federal standard of care for investment advisers.[8] This standard includes the requirement that investment advisers make a reasonable determination that the investment advice they provide is suitable for the client based on the client's financial situation and investment objectives.[9] The Commission has stated

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[5] Investment advisers have an affirmative duty under the Advisers Act to act in their client's best interests by exercising their responsibilities with the utmost good faith, making full and fair disclosure of all material facts, and employing reasonable care to avoid misleading clients. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194-95 (1963). Further, in the retail brokerage context, many in the industry already operate under a best interests standard that shares the same foundational principles as the Fiduciary Rule. FINRA Rule 2111 incorporates principles that are designed such that a broker-dealer's recommendations are consistent with their customers' best interests.

[6] *See* Uniform Trust Code § 804 (Jan. 2013) ("A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution").

[7] ERISA Section 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B); *see also* 29 C.F.R. § 2550.404a-1. The ERISA prudence rule is based on common law principles. *See, e.g., Fink v. National Sav. & Trust Co.*, 772 F.2d 951, 955 (D.C. Cir. 1985).

[8] *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 471 n.11 (1977) (noting that "Congress intended the Investment Advisers Act to establish federal fiduciary standards for investment advisers").

[9] U.S. Securities and Exchange Commission, Staff of the Division of Investment Management, *Robo-Advisers*, IM Guidance Update No. 2017-02 (February 2017). *See also* Suitability of Investment Advice Provided by Investment Advisers, Investment Advisers Act Rel. No. 1406 (Mar. 16, 1994) ("Proposed Suitability Rule").

that an adviser's duty of care requires it to "make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information."[10] Further, under FINRA Rule 2111, broker-dealers and their associated persons must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the investor, based on information obtained through "reasonable diligence" to ascertain that investor's investment profile.[11] FINRA takes the position that Rule 2111 incorporates the obligation that a broker-dealer's recommendations be consistent with their customers' "best interests."[12]

In this regard, the standard of care codified in each of the Advisers Act, FINRA Rule 2111, ERISA, and common law reflect a core prudence standard under which an advice provider must perform a reasonable inquiry into an underlying investor's financial needs, investment objectives and appetite for risk in order to form a sufficient basis for the advice that is provided. What these disparate regulatory standards have in common is that by imposing this standard of care, they have created the obligation for advice providers to adopt processes to obtain relevant information about their clients' investment needs and circumstances, and to formulate investment recommendations tailored to that information. The degree to which these standards reflect core components of the fiduciary duty of care is a compelling reason to unite them into a single standard of conduct.

2. ***Registered investment advisers and broker-dealers should take steps to identify and manage conflicts of interest so that such conflicts do not result in imprudent investment advice.*** Under common law, the duty of loyalty requires that trustees act in the interests of trust beneficiaries, avoid conflicts of interest unless they are disclosed to, and consented to by, the beneficiaries, and deal with beneficiaries fairly.[13] A duty of loyalty that places a client's interests ahead of their advice provider's competing financial interests is rooted in longstanding principles under ERISA and the Advisers Act that are based on the common law of agency and trusts.[14] Indeed, a duty of loyalty that requires

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Although the Commission did not adopt the Proposed Suitability Rule, the Staff of the Division of Investment Management has taken the position that "the rule would have codified existing suitability obligations of advisers and, as a result, the proposed rule reflects the current obligation of advisers under the [Advisers] Act." See Staff of the Investment Adviser Regulation Office, Division of Investment Management, US Securities and Exchange Commission, Regulation of Investment Advisers by the U.S. Securities and Exchange Commission at 23 (Mar. 2013).

10 Concept Release on the U.S. Proxy System, Investment Advisers Act Release No. 3052 (July 14, 2010) at 119.

11 FINRA Rule 2111(a).

12 FINRA Suitability FAQ at Q7.1, accessible at http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq (last accessed February 3, 2018); FINRA Regulatory Notice 11-02, Know Your Customer and Suitability (January 2011) at FN 11.

13 Rest. 3d Trusts § 78 Duty of Loyalty (2007).

14 Best Interest Contract Exemption, 81 FR 21002 (Apr. 8, 2016) at text accompanying FN 42 ("The Impartial Conduct Standards represent fundamental obligations of fair dealing and fiduciary conduct. The concepts of prudence, undivided loyalty and reasonable compensation are all deeply rooted in ERISA and the common law of agency and trusts."); Commission Study on Uniform Fiduciary Standard, *supra* note 3 at text accompanying

advice providers to avoid or manage conflicts of interest that they have with investors is an existing component of each of the regulatory standards under the FINRA Rules, Advisers Act, ERISA and the impartial conduct standards under the Best Interest Contract ("BIC") Exemption.

As the Commission considers adopting a standard of conduct that incorporates a duty of loyalty, we believe it should ensure that a duty of loyalty be implemented through a principles-based approach that preserves financial institutions' flexibility to avoid or manage conflicts in which they have a competing financial interest, provided they fully and fairly disclose the nature of such conflicts to investors and take such additional steps as may be necessary to ensure that conflicts do not adversely affect the impartiality and prudence of the advice they provide to investors. We urge the Commission to avoid mandating that advice providers comply with inflexible or prescriptive rules to address conflicts in their business models. Indeed, one of the key issues with the Department of Labor's Fiduciary Rule is its inflexible approach (through the conditions of the related exemptions) to addressing conflicts through defined requirements for customer contracts and policies and procedures, which could force the financial services industry to limit the choice of investor services and move into a one-size-fits-all offering.

We note that what we are proposing is more than just a disclosure-based standard. While disclosure is a critical means of informing investors about the services they are receiving and the standard of conduct applicable to their advice relationship, the duty of loyalty generally requires that advice providers actually implement controls to prevent conflicts of interest from tainting the impartiality of advice. We are asking for flexibility to allow financial institutions to develop compliance regimes to protect investors in the most appropriate way for their evolving business models.

3. ***Registered investment advisers and broker-dealers should clearly and fairly disclose information about their services, investment products, compensation and conflicts of interest.*** We believe a key element of the harmonized standard of conduct is a requirement that both registered investment advisers and broker-dealers provide a clear and comprehensive disclosure to retail investors explaining material information about their services, including the nature of the services, investment products, compensation, and material conflicts of interest. Investment advisers are already subject to a disclosure-based regime under the Advisers Act in which they are required to make full and fair disclosure (generally through Form ADV) of all material facts, including conflicts of interest between the adviser and its clients, and any other material information that could affect the advisory relationship. However, there is currently no requirement that broker-dealers provide a comparable disclosure. In this regard, the Commission should consider adopting a disclosure document for broker-dealers that requires disclosure of information about the brokerage relationship, including information about their services, fees and compensation, and material conflicts of interest.

FN 86 ("The duty of loyalty requires an adviser to serve the best interests of its clients, which includes an obligation not to subordinate the clients' interests to its own.")

Indeed, FINRA has stated (and we agree) that an upfront disclosure document written in plain English would benefit retail customers by "providing useful information" and help to "clearly define the scope of the duties owed to that customer."[15] Such disclosures should, as FINRA notes, describe the type of accounts and scope of services provided to retail investors, the financial or other incentives that an advice provider or its financial professionals have to recommend certain products or strategies, and limitations on the duties that the advice provider owes to its customers.[16] Form ADV may form the basis for developing a disclosure for broker-dealers because it has proven to be an effective means of communicating key disclosures about investment advisers' conflicts of interest and material business practices to clients, and the industry's widespread familiarity with this format could speed its adoption. We believe that a strong disclosure regime is necessary to empower retail investors to better understand their choices as to how to best meet their investment and savings goals and objectives, and to compare the costs of different services and products so they can choose the ones most appropriate for their needs.

II. A Principles-Based Standard Permitting Flexibility in Approach to Compliance

We note that principles identified above underlie, and are consistent with, the "impartial conduct standards" the Department of Labor formulated in the BIC Exemption. As the Department of Labor has stated, financial institutions have flexibility as to how they meet the impartial conduct standards,[17] and thus they may tailor their approach to their particular business models and services. In contrast, the overly prescriptive conditions of the BIC Exemption that are currently slated to become applicable on July 1, 2019 present a heavy financial and compliance burden for financial institutions, as well as significant legal risks, that hinder their ability to effectively provide investment advice to an investing public that is increasingly seeking holistic investment advice and planning services. In developing a standard of conduct, we urge the Commission to adopt a principles-based approach reflecting the elements discussed above, and to avoid prescribing specific policies and procedures or other requirements so that financial institutions can retain flexibility to adapt their approach to their business model and to facilitate innovation in the financial services industry.

The Commission has consistently taken the position in other contexts that advice providers should have the flexibility to adopt policies and procedures that are tailored to their business activities and the nature of the services that they provide. Indeed, Advisers Act Rule 206(4)-7 requires advisers to establish an internal compliance program consisting of written policies and procedures that are reasonably designed to prevent an adviser and its employees from violating the Advisers Act. That rule does not, as the Commission notes, "enumerate specific elements that advisers must include in their policies and procedures (…) Each adviser should adopt policies and procedures that take into consideration the nature of that firm's operations."[18] Similarly, the

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15 Disclosure of Services, Conflicts and Duties, FINRA Regulatory Notice 10-54 (Oct. 2010).

16 *Id.* at 3-4.

17 U.S. Department of Labor, Employee Benefits Security Administration, Conflict of Interest FAQs (Transition Period) (May 2017), accessible at https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-transition-period-1.pdf.

18 Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Rel. No. 2204 (Dec. 17, 2003).

FINRA Rules also require broker-dealers to establish and maintain a written compliance program that is "reasonably designed" to fulfill the FINRA Rules, including supervision of the activities of the broker-dealer's associated persons and the business activities in which they engage.[19] We urge the Commission to follow a similar approach with respect to any standard of conduct it may adopt.

III. Harmonization with the Department of Labor's Fiduciary Rule

A primary concern of the Department of Labor in designing its Fiduciary Rule was that the Department did not have the ability to enforce the rule with respect to individual retirement accounts and other non-ERISA plans ("IRAs"). To address this, the Department created a private right of action to enforce the impartial conduct standards and required warranties regarding the specific policies and procedures requirements under the BIC Exemption.[20] In doing so, the Department created significant, unbounded exposure to class action litigation risk, that many fear will limit the availability of investment services and choice to retail retirement investors.[21]

If, as suggested, the Commission adopts a standard of conduct outlined above, which would be consistent with the Department of Labor's approach in developing the impartial conduct standards, the Commission (as well as FINRA with respect to broker-dealers) would be able to enforce the standard, not just with respect to IRAs, but with respect to all retail accounts. The Commission and FINRA have active and effective examination and enforcement programs that can be leveraged to ensure that the standard of conduct is adhered to, which would serve to address the Department's concerns of ensuring that the impartial conduct standards have "teeth." As such, the Department would not need to rely on the plaintiff's bar and the courts to enforce protective standards, making the private right of action and policies and procedures requirements under the BIC Exemption unnecessary. Instead, the Department could adopt an exemption that would condition availability on being subject to, and complying with, the Commission's standard of conduct.

By contrast, the unconstrained potential litigation risks associated with the Fiduciary Rule's private right of action may have the long-term effect of driving firms to adopt a one-size-fits-all approach when providing advice to retail investors in order to avoid potential liability. In this regard, the Fiduciary Rule may stifle innovation and the development of products and services that are tailored to retail investor's financial needs. Therefore, we urge the Commission to move forward with a standard of conduct that it (and FINRA) can enforce to protect all retail investors,

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19 *See, e.g.,* FINRA Rules 3110, 3120.

20 *See* Best Interest Contract Exemption, *supra* note 14, at 21041 (discussing Section II(f) of the Exemption).

21 We note that many have focused on the BIC Exemption's prohibition against class action waivers as creating or expanding class action litigation risk. However, that is not the case for broker-dealers because FINRA's position has historically been that entities subject to its jurisdiction cannot include such waivers in pre-dispute arbitration agreements. See In re Dep't of Enforcement v. Charles Schwab & Co., 2014 WL 1665738 (FINRA Bd. 2014). Rather, the key drivers of increased class action risk are the BIC Exemption's specific and prescriptive requirements that could form the basis for uniformity of claims required for class actions, regardless of the extent or nature of investment losses, if any, experienced by a particular investor.

while preserving choice, access to services, and innovation in the investment advice market-place.

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Thank you for considering our comments and suggestions. We look forward to working collaboratively with the Commission to better serve and protect American investors. Please do not hesitate to contact me should you wish to discuss any of the concepts set forth in this letter.

Sincerely,

Michelle Oroschakoff

Michelle B. Oroschakoff