

6 April 2018

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Re: Standards of Conduct for Investment Advisers and Broker-Dealers – Follow-up Questions from Staff

Dear Messrs. Gilbride, Timura and Ryan:

CFA Institute¹ appreciates the opportunity to have met with staff (the “Meeting”) of the Securities and Exchange Commission (“SEC” or the “Commission”) to discuss the letter CFA Institute submitted on 10 January² in response to the Chairman’s request for information on standards of conduct for investment advisers and broker-dealers (the “Response”). This letter is to respond to questions raised during the Meeting.

¹ CFA Institute is a global, not-for-profit professional association of nearly 160,000 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries and territories, of which more than 150,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 150 member societies in 69 countries and territories.

² <https://www.cfainstitute.org/Comment%20Letters/20180110.pdf>

At what point does CFA Institute believe advice should be considered personalized? As noted in our letter, the Investment Advisers Act of 1940 (the “Act”) describes what is “impersonal investment advice” — oral statements or written material that do “not purport to meet the objectives or needs of specific individuals or accounts.” It does not, however, describe what constitutes personalized investment advice. We called upon the SEC to add clarity to these matters by describing what is and is not personalized advice.

During the Meeting, Commission staff inquired as to how CFA Institute believes personalized investment advice should be defined. This was seen as important because calling for this definition and by calling for clarity on titles (discussed below) was apparently seen by staff as fundamentally changing the nature of the securities brokerage business.

We do not agree with the view that what we are suggesting and requesting in our Response is a fundamental change in the securities brokerage business model. Rather, we see our Response as returning enforcement of the Act to what was originally intended by a) asking the Commission to clarify its interpretation of what personalized investment advice means under the Act and, by extension, at what point brokers must register as investment advisers, and b) then to enforce that interpretation. If this, in turn, leads to a restructuring of the securities brokerage industry, then the implication is that through their business models, these firms and their representatives were engaged in activities that are not consistent with what the Act permits.

Please note that CFA Institute has a diverse membership whose professional activities cover a wide spectrum of the investment industry. Based on data provided by members, between 15% and 18% work for sell-side firms, including many who identify as “financial advisors.” Given these demographics, we do not lightly suggest policies that may hurt one segment of the industry because doing so will likely affect a segment of our membership, as well. We made the proposals in the Response, nevertheless, because we believe these changes are needed to increase accountability for personalized advice and reduce investor confusion, and because we believe they will cause the least disruption in the market of the alternatives available.

As an organization, CFA Institute regularly and uniformly abstains from suggesting “bright-line” rules or definitions for various types of financial regulations and standards. We recognize that there is no consequential difference between requiring a firm with a market capitalization of \$50.001 million to refrain from an activity that another whose valuation is \$49.999 million is allowed to do.

In the same way, we refrain in this case from attempting to stipulate bright-line triggers for when advice becomes personalized. We recognize there are varying circumstances that may place brokers in the position of providing investment advice that is either ancillary or essential to their clients’ financial well-being. We also recognize that determining which side of this divide the advice will fall is an issue that has bedeviled the Commission for many years.

What we do state in the Response is, in general terms, that personalized investment advice is “intended to influence the investment decisions and actions of specific individuals or accounts.” The need for clarity on definitions and titles would help make this distinction clearer in the minds of investors. In the end, we believe determination of when advice becomes more than

incidental has to do both with the frequency of the advice and/or the magnitude of the investment decisions the advice creates. Again, though, we defer to the experts at the Commission on where the delineation is made.

What benefits would come from changing enforcement around the incidental advice exemption?

We see three primary benefits arising from additional clarity about what constitutes investment advice and who must register as investment advisers.

First, we believe clarity will give brokers greater awareness of what is and is not permitted without having to register as investment advisers. This may prevent some brokers from engaging in advice they didn't realize was not permitted.

Second, clarity in these matters will ensure the law is enforced as it is written. Currently, the titles used combined with the advice they provide, brokers give investors the impression that they are trusted investment advisers rather than securities salespeople. By clarifying what constitutes personalized advice and the titles that will require a broker to register will further enhance investors' understanding of what brokers do, how they get paid, and how they address real and potential conflicts of interest in contrast with registered investment advisers.

And finally, clarity in what constitutes personalized advice and when adviser registration is required will lead to consistency between what the law and regulation say and the way brokers operate. Ultimately, this, we believe, will lead to reduced confusion for investors and thus increased investor protection.

Why did CFA Institute choose broker disclosure rather than a higher standard of care for broker-dealers?

As stated in the Response, we believe securities brokers play an important and efficient role in helping U.S. securities markets function. Our goal in suggesting the approaches given in the Response was, first, to provide distinction and clarity between investment advisory and securities brokerage activities, and, second, to preserve as much as possible the securities brokerage business model.

We believe it is imperative that those providing personalized investment advice operate under a fiduciary duty rule. In contrast, we also support investors having the option to transact with securities brokers who offer sales pitches together with efficient transaction execution.

Merely raising the bar somewhat for securities brokers, by contrast, without completely reaching a fiduciary standard of care would have had two conceivable negative outcomes. First, it may further reduce the availability of (potentially) lower-cost investment options for investors. We believe that retaining this option is more valuable than incrementally raising the standard of care bar. Second, raising the bar incrementally would preserve, or perhaps even exacerbate the

confusion about the standards of care brokers provide to their clients as compared with what investment advisers provide.

Conclusion

We believe the SEC has the authority and a timely opportunity to clarify the legal contours of investment advisers, personalized investment advice, the incidental exemption and titles used in the financial services industry by using administrative guidance. Regardless of how the Commission addresses these matters, however, we strongly encourage action along the lines we have suggested in the Response and in this letter. We believe these actions will go far to address the confusion over the roles of broker-dealers, restore investor trust, and restore the intended use of the Advisers Act's incidental exclusion.

Should you have any questions about our positions, please do not hesitate to contact James Allen, CFA [REDACTED].

Sincerely,

/s/ James Allen

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