

August 3, 2018

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: Comments on Regulation Best Interest; Release No. 34-83062; File Number S7-07-18 and Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation; Release No. 34-83063; File Number S7-08-18

Dear Mr. Fields:

The American Retirement Association (“ARA”) thanks the Securities and Exchange Commission (“Commission”) for the thought and effort dedicated to its regulatory package consisting of the proposed Regulation Best Interest, 83 Fed. Reg. 21574 (May 9, 2018), Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, 83 Fed. Reg. 21203 (May 9, 2018), (the “Proposed Interpretation”), and Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles, 83 Fed. Reg. 21416 (May 9, 2018) (collectively, the “Proposals”). We appreciate the opportunity to comment on the proposed continuing education requirements and share our concerns regarding the definition of “retail customer”, and financial responsibility requirements for investment advisers.

ARA is the coordinating entity for its five underlying affiliate organizations representing the full spectrum of America’s private retirement system, the American Society of Pension Professionals and Actuaries (“ASPPA”), the National Association of Plan Advisors (“NAPA”), the National Tax-deferred Savings Association (“NTSA”), the ASPPA College of Pension Actuaries (“ACOPA”), and the Plan Sponsor Council of America (“PSCA”). ARA’s members include organizations of all sizes and industries across the nation who sponsor and/or support retirement saving plans and are dedicated to expanding on the success of employer-sponsored plans. In addition, ARA has more than 24,000 individual members who provide consulting and administrative services to American workers, savers, and the sponsors of retirement plans. ARA’s members are diverse but united in their common dedication to the success of America’s private retirement system.

Executive Summary

ARA and its underlying affiliate organizations have long been supportive of initiatives by the federal government to improve the private retirement system. ARA looks forward to working with the Commission to provide input throughout the regulatory process. We support the principle underlying the Proposals, which is that investors are best served when the interests of the financial services professional and investors are aligned. In particular, ARA supports putting the interests of investors (and particularly retirement investors) front and center under a “best interest” standard. Furthermore, we support the Commission’s efforts to tailor these rules to preserve investor choice with regard to business models and compensation practices in a manner that is workable for broker-dealers and investment advisers alike. Consistent with this support, ARA provides the following comments with respect to Regulation Best Interest and the Proposed Interpretation:

- Net capital requirements are inappropriate for the advisory business and particularly burdensome to small advisory firms.
- The Commission should clarify that broker-dealers' recommendations to non-professional fiduciaries of small retirement plans are required to comply with the best interest obligation because such fiduciaries are "retail customers" within the meaning of Regulation Best Interest.
- Broker-dealers' compliance with U.S. Department of Labor ("DOL") disclosure requirements when providing investment advice to small retirement plan fiduciaries should be deemed to satisfy Regulation Best Interest's disclosure requirements.
- A federal licensing regime is overly duplicative of state efforts that near-universally require the Series 65 license.
- Provision of account statements is an onerous and costly requirement that duplicates efforts by custodians.

I. Net Capital Requirements are Inappropriate for the Advisory Business and are Particularly Burdensome to Small Advisory Firms.

The primary purpose of the FINRA net capital rule is to ensure that broker-dealers maintain sufficient liquid assets to promptly satisfy the claims of customers, creditors, and other broker-dealers as well as to provide a buffer in the event that market or credit risk requires liquidation.¹ However, the Commission's rationale for proposing a similar financial responsibility requirement on investment advisers is much narrower in scope. The proposal endeavors to ensure that firms have sufficient assets to compensate defrauded customers in the event of "serious fraud" and to ensure that clients are made whole should the adviser become subject to bankruptcy proceedings.²

There are already sufficient investor protections in place to address misappropriation and bankruptcy. The Commission has already installed protections under the Custody Rule and Section 206(4)-7 of the Advisers Act to guard against the misappropriation of client assets that are tailored to the advisory business model. All advisers with custody of client assets must undergo an annual surprise examination by an independent public accountant and they are subject to anti-fraud rules. Advisers must also disclose any material financial condition that impairs their ability to provide services to their clients.

The problems of potential RIA misappropriation and bankruptcy are overstated. The number of actions against RIAs is low and pales in comparison to the number of allegations brought against brokers through FINRA arbitration. In 2017, over eighty-six percent of all registered RIAs reported no disciplinary history at all and only one percent of all advisers reported that they or their affiliates had been charged with a felony.³ While the SEC and FINRA do not make bankruptcy statistics readily available,

¹ *Risk-Based Capital: Regulatory and Industry Approaches to Capital and Risk*, Appendix 11. GAO/GGD-98-153. Washington, D.C.: United States Government Accountability Office (GAO), 1998.

Report to the Chairman, Committee on Banking, Housing, and Urban Affairs, U. S. Senate, and the Chairman, Committee on Banking and Financial Services, House of Representatives

² "Should investment advisers be subject to net capital or other financial responsibility requirements in order to ensure they can meet their obligations, including compensation for clients if the adviser becomes *insolvent or advisory personnel misappropriate clients' assets*?"

See 83 Fed. Reg. 21203 (May 9, 2018)

³ Barr, Karen. "Evolution Revolution Report (2017)." Investment Adviser Association, 2017, www.investmentadviser.org/publications/evolution-revolution. Published August 1, 2017.

we did take the time to submit a Freedom of Information Act (FOIA) request for Form ADV data.⁴ Analysis of a statistically significant random sample of 2018 submissions produced a rate of business bankruptcy of 0.00%. Our analysis is consistent with data made available by the Certified Financial Planner (CFP) Board which suggests a .01% rate of personal bankruptcy for financial planners.⁵

Net capital requirements are more appropriate for firms that hold assets. An adviser is an agent of his or her client and does not maintain custody of client assets or put their own capital at risk. In contrast, as dealers, broker-dealers act on behalf of the firm as a principal and trade securities on their own account to help to create markets in securities. Broker-dealers buy and sell securities, distribute other investment products and maintain custody of client assets. It is the unique role of a broker-dealer and the financial incentives at play that merit enhanced investor protections in the brokerage world (like net capital rules) that are not applicable in the Registered Investment Adviser (“RIA”) space.

Net Capital Requirements stifle small business and have an anti-competitive effect. Net capital requirements are unduly burdensome to advisory firms many of which are small businesses with the average SEC-registered RIA employing no more than 9 professionals. The advisory business model requires low overhead and is not cash intensive since assets under management are not balance sheet assets. Larger firms, however, are better positioned to satisfy potential capital requirements and this will have an anti-competitive effect on smaller firms with less access to capital. One formulation under FINRA’s net capital rule provides for a \$250,000 minimum. It would be imprudent to impose capital requirements on these small business just to capture a few bad actors – the means do not justify the ends.

II. The Commission Should Clarify that Retail Customers Include Non-Professional Fiduciaries of Small Retirement Plans

The proposed Regulation Best Interest defines a “retail customer” as: “a person, or the legal representative of such person, who: (A) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer or a natural person who is an associated person of a broker or dealer; and (B) Uses the recommendation primarily for personal, family, or household purposes.”⁶ In the preamble to the proposed Regulation Best Interest, the Commission clarified that it had crafted this definition to “cover non-natural persons that the Commission believes would benefit . . . (such as trusts that represent the assets of a natural person).”⁷ The Commission also stated the definition would cover recommendations given directly to the participants of plans covered by the Employee Retirement Income Security Act of 1974, as amended (“ERISA”).⁸ ARA believes the Commission should clarify that non-professional fiduciaries of small employer-sponsored retirement plans are covered by the “retail customer” definition.

Regulation Best Interest makes clear that the Commission is seeking to minimize the impact of conflicts within the financial services marketplace. While pursuing this worthy objective, it is important to recognize that a significant percentage of assets within the U.S. financial system are held in employer-sponsored retirement plan accounts. In this regard, the Commission appropriately determined that recommendations to rollover or transfer assets from retirement plans should be covered under Regulation

⁴ The ARA submitted a FOIA request through the SEC’s Office of FOIA Services for all responses to Item 18 of Form ADV Part 2 over the past three year. A review of a statistically significant random sample of 2018 responses yielded a rate of bankruptcy of 0%.

⁵ In 2013, 7 of the 67,000 CFP designees filed for personal bankruptcy (a .01% rate).

See “CFP BOARD DISCLOSES BANKRUPTCIES BY CFP® PROFESSIONALS.” Code and Standards, CFP® Board, 18 Apr. 2014, www.cfp.net/news-events/news-release-archive/article/2014/04/18/cfp-board-discloses-bankruptcies-by-cfp-professionals

⁶ Proposed Rule § (b)(1), 83 Fed. Reg. 21574, 21595–96 (May 9, 2018).

⁷ 83 Fed. Reg. 21574, 21596 (May 9, 2018).

⁸ 83 Fed. Reg. 21574, 21598 (May 9, 2018).

Best Interest.⁹ However, many participants may not rollover their retirement plan accounts until they reach retirement age and therefore may hold their retirement savings in workplace retirement accounts for 30 to 40 years. Employer-sponsored retirement plans hold \$16.9 trillion on behalf of their participants and beneficiaries.¹⁰ Fifty-five percent of Americans households participate in employer-sponsored plans.¹¹

Therefore, ARA believes that it is paramount that financial professionals be held to a high standard of care when providing investment advice to individuals responsible for retirement plan assets. To this aim, ARA suggests that the Commission further clarify Regulation Best Interest to avoid any “gap” in regulatory coverage. Simply put, broker-dealers should be held to the same standards of conduct when providing investment advice to a small retirement plan fiduciary as when providing advice to an individual plan participant or IRA holder. Broker-dealers routinely advise the fiduciaries of small retirement plans concerning the investments made or made available to participants under such plans.¹² Fiduciaries of small retirement plans may not have independent financial or investment expertise and therefore may rely on broker-dealers’ recommendations when making investment decisions on behalf of their plans.

Moreover, the quality of such investments available under a plan can have a profound impact on a participant’s accumulation of retirement savings over the course of his or her working career. For example, a 50 basis point difference in investment returns, net of fees, over the course of 35 years can mean a difference in more than \$100,000 in accumulated retirement savings.¹³ Thus, requiring recommendations to small plan fiduciaries to adhere to the Regulation Best Interest’s best interest standard would redound to the benefit of plan participants. Further, recommendations to the non-professional fiduciaries of small plans are already subject to FINRA suitability obligations.¹⁴

A close textual reading suggests that retirement plan fiduciaries may qualify as a “retail customer” under the language of the proposed Regulation Best Interest because they act as the “legal representative” of plan participants by exercising control over participants’ beneficial interest in the plan. Fiduciaries of retirement plans include persons with discretionary authority or control respecting the management of a plan or the disposition of its assets.¹⁵ These plan fiduciaries make investment decisions, enter into contracts, pursue legal claims, and among other things, interact with regulators, on behalf of the plans they serve.¹⁶ At common law, a fiduciary relationship is based on a relationship of trust and

⁹ See 83 Fed. Reg. 21574, 21603 (May 9, 2018).

¹⁰ Investment Company Institute, 2018 Investment Company Factbook, 170, *available at* https://www.ici.org/pdf/2018_factbook.pdf

¹¹ *Id.* at 171.

¹² In connection with defined contribution plans, such as 401(k) plans, broker-dealers may provide recommendations concerning the menu of investment options from which plan participants may select to direct the investment of their plan accounts. In the context of defined benefit plans, broker-dealers may recommend the investments that comprise the plan’s investment portfolio. On the other hand, in our experience, the fiduciaries of large plans are more likely to be advised by a registered investment adviser than a broker-dealer.

¹³ Assuming a participant contributes \$10,000 per year during a career of 35 years. The Department of Labor’s regulatory impact analysis in connection with its fiduciary investment advice regulation estimated a cost associated with broker-dealers’ conflicted mutual fund recommendations of 50–100 basis points of annual underperformance, on average. 80 Fed. Reg. 21928, 21952 (Apr. 20, 2015); Department Labor, Regulating Advice Markets: Regulatory Impact Analysis for Final Rule and Exemptions, 9 (Apr. 2016).

¹⁴ See FINRA Notice 12-25, Q.6 (May 2012).

¹⁵ See ERISA § 3(21). The type of retirement plan fiduciary that we recommend be included within the retail customer definition may be the employer sponsoring the plan or an employee or group of employees of the sponsoring employer exercising overall management over the plan’s governance. As described below, we do not believe that professional investment experts retained by the plan to perform investment advisory services in a fiduciary capacity should be included.

¹⁶ See *DOL v. Koresko*, 646 Fed. Appx. 230, 237 (3d Cir. 2016) (stating fiduciary duties attach to management of assets in which plan participants have a beneficial interest); ERISA § 502(a)(3) (providing a private right of action for ERISA fiduciaries to enforce the terms of the plan).

confidence, where one person relies on, and is dependent on, the other.¹⁷ Similarly, it is well-recognized that fiduciaries may act as the legal representative of the persons they serve, meaning that retirement plan fiduciaries act as “legal representatives” of underlying plan participants and beneficiaries.¹⁸ Therefore, ARA suggests that the Commission clarify that non-professional small retirement plan fiduciaries are the “legal representatives” as contemplated under Regulation Best Interest, of retirement plan participants.

Similarly, and as noted above, the Commission explained that retirement plan participants and IRA holders are considered “retail customers” under the current definition because investment recommendations to such individuals would be used primarily for “personal, family, or household purposes.”¹⁹ The Commission also more broadly articulated that recommendations made for retirement purposes constitute recommendations for personal, family or household purposes, as opposed to business or commercial purposes.²⁰ While ARA agrees with the Commission’s analysis, ARA proposes that the Commission clarify that the same analysis applies to a broker-dealer’s recommendations to a non-professional small plan fiduciary. In this respect, the Commission should clarify that small plan fiduciaries are the legal representatives of plan participants and that recommendations to such fiduciaries will be covered recommendations to retail customers within the meaning of Regulation Best Interest because those recommendations will ultimately be used by the plan participants for personal, family, or household purposes.

III. Compliance with DOL Disclosure Requirements Should Be Deemed Sufficient to Satisfy Regulation Best Interest’s Disclosure Requirements Where a Broker-Dealer Provides Recommendations to Small Retirement Plan Fiduciaries

As described above, the ARA believes that Regulation Best Interest should apply where broker-dealers provide recommendations to the fiduciaries of small retirement plans. However, to reduce uncertainty, unnecessary compliance costs, and confusion the Commission should clarify that compliance with the rigorous and multi-layered disclosure scheme already applicable to broker-dealers when providing investment advice to small plan fiduciaries would satisfy Regulation Best Interest’s disclosure requirements. The overlapping disclosure requirements include those under the DOL’s 408b-2 regulation²² (citation) and disclosures required with respect to Schedule C to Form 5500.(citation)

The DOL’s 408b-2 regulation requires plan service providers, including broker-dealers, to provide a comprehensive set of disclosures to retirement plan fiduciaries sufficient to allow plan fiduciaries to assess the merits of the service arrangement.²³ In this regard, the information that must be disclosed includes, among other things:

- a description of the services the service provider will or reasonably expects to provide pursuant to the contract or arrangement;
- whether the service provider will provide services as a fiduciary under ERISA or as an investment adviser registered under the Investment Adviser Act of 1940, as amended;
- a description of all compensation the service provider, its affiliates, and subcontractors will receive or reasonably expect to receive directly from the plan client;
- a description of all compensation the service provider, its affiliates, and subcontractors will receive or reasonably expect to receive from parties other than the plan client in connection with

¹⁷ *Schneider v. Plymouth State Coll.*, 744 A.2d 101, 105 (1999); Bogert, *The Law Of Trusts And Trustees* § 481 (2018).

¹⁸ See Representation by Fiduciaries and Parents, Unif.Trust Code § 303, Comment (2000).

¹⁹ 83 Fed. Reg. 21574, 21598 (May 9, 2018).

²⁰ See 83 Fed. Reg. 21574, 21595 and 21598 (May 9, 2018).

²² 29 CFR 2550.408b-2

²³ 77 Fed. Reg. 5632 (Feb. 3, 2012).

the contract or arrangement, including identification of the payer of such compensation and the services for which such compensation will be paid;

- a description of all compensation that will be paid among the service provider, its affiliates, and subcontractors, including the payer of the compensation and the services for which such compensation is paid; and
- a description of any compensation the service provider, its affiliates, and subcontractors reasonably expect to receive in connection with termination of the contract or arrangement.²⁴

The DOL disclosure requirements, as described above, substantially overlap with Regulation Best Interest's disclosure requirements. To the extent they apply to a broker-dealer, they would both require the broker-dealer to disclose the material facts concerning the relationship, including the services the broker-dealer will provide, whether the broker-dealer will act in a fiduciary capacity and the fees and expenses that will be charged.²⁵ While the DOL disclosure requirements do not directly require disclosure of conflicts of interest, the ascribed purpose of the mandated disclosure of direct and indirect compensation is to provide plan fiduciaries with information to assess potential conflicts of interest.²⁶ For example, the 408b-2 regulation and Form 5500 Schedule C require disclosures regarding soft-dollar arrangements and revenue sharing.²⁷ As a result, the DOL disclosure requirements and the disclosure requirement under Regulation Best Interest achieve the same ends.

Therefore, ARA believes that applying Regulation Best Interest's disclosure requirements where broker-dealers make recommendations to small retirement plans would not have a positive effect, and could even be harmful. There is widespread concern that the retirement space is already overburdened with mandated disclosures.²⁸ Adding a new disclosure for small retirement plan fiduciaries may cause them to feel even more overwhelmed and to disengage from the oversight process. Moreover, such fiduciaries would almost certainly be confused as a result of receiving a disclosure, as a result of Regulation Best Interest, that contains the same information previously provided to them through the DOL-mandated disclosure materials.

IV. Federal Licensing Regime is Overly Duplicative of State Efforts That Require the Series 65 License

The Commission proposes federal licensing and continuing education requirements that are designed to address minimum and ongoing competency requirements. While advisers are not currently subject to licensing requirements akin to brokers under FINRA, they are subject to a higher standard of care at the Federal level. The perceived gap between brokers and adviser is further diminished by the fact that most states have imposed registration, licensing, or qualification requirements on investment adviser

²⁴ 29 C.F.R. § 2550.408b-2(c)(1)(iii)-(iv).

²⁵ See Proposed Rule § (a)(2)(i); 29 C.F.R. § 2550.408b-2(c)(1)(iv).

²⁶ 77 Fed. Reg. 5632, 5637 (Feb. 3, 2012) ("The Department determined that the most effective way to achieve disclosure of conflicts of interest for purposes of the final rule is to inform plan fiduciaries of what compensation will be received and from whom.")

²⁷ 29 C.F.R. § 2550.408b-2(c)(1)(iv)(C)(3); 2017 Form 5500 Instructions at 25 (available at <https://www.dol.gov/sites/default/files/ebsa/employers-and-advisers/plan-administration-and-compliance/reporting-and-filing/form-5500/2017-instructions.pdf>).

²⁸ Department of Labor, Regulating Advice Markets: Definition of the Term "Fiduciary" Conflicts of Interest- Retirement Investment Advice, Regulatory Impact Analysis for Final Rule and Exemptions, at 268 (Apr. 2016), available 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> (citing Hung, Angela, Noreen Clancy, Jeff Dornitz, Eric Talley, Claude Berrebi, and Farrukh Suvankulov. *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008)); Advisory Council on Employee Welfare and Pension Benefit Plans, Mandated Disclosure for Retirement Plans – Enhancing Effectiveness for Participants and Sponsors, 7 (Nov. 2017), available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/about-us/erisa-advisory-council/2017-mandated-disclosure-for-retirement-plans.pdf>.

representatives who have a place of business in the respective state (regardless of federal registration status). In most states, Investment Adviser Representatives (IARs) are required to take the Series 65 exam as a pre-requisite for becoming a representative of an RIA. The Series 65 exam covers topics, such as fiduciary responsibility, retirement planning, and portfolio management, to ensure a licensee can competently provide investment advice. The Series 65 exam and licenses are tailored to the adviser business model much like the FINRA broker licensing regime is designed to prepare brokers to sell specific investment products. Imposing a federal licensing requirement would be overly duplicative of state efforts that require the Series 65 license.

V. Provision of Account Statements is an Onerous and Costly Requirement that Duplicates Efforts by Custodians

While ARA agrees with the SEC that an investment adviser can and should make personalized fee information available upon request, ARA believes a mandated periodic reporting requirement as proposed by the Commission is unnecessary.²⁹ Form ADV and proposed CRS each provide investors with sufficient information to understand the types of fees charged, the compensation conflicts that exist and whether further inquiry is necessary. The periodic provision of personalized fee statements (absent an investor request or inquiry) imposes an unnecessary and costly compliance burden on many investment advisers all the while threatening investors with disclosure fatigue – a counterproductive end.

Conclusion

ARA appreciates the ongoing opportunity to work with the Commission on these issues of great importance to our diverse membership of retirement marketplace participants. We would welcome the opportunity to discuss these comments further with you. Please contact Joe Caruso, Government Affairs Counsel, at JCaruso@USARetirement.org or Doug Fisher, Director of Retirement Policy, at DFisher@USARetirement.org if you have any questions. Thank you for your time and consideration.

Sincerely,

/s/

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²⁹ Financial professionals are “well positioned to provide individualized fee information to their retail investors *upon request*.” See 83 Fed. Reg. 21432 (May 9, 2018).