



Robin C. Swope

Director, Global Product Governance & Support

Invesco Advisers, Inc.

11 Greenway Plaza, Suite 1000
Houston, Texas 77046-1173

Direct [REDACTED]
[REDACTED]

www.invesco.com

August 7, 2018

Submitted electronically through <http://www.regulations.gov>

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: *Standards of Conduct for Investment Advisers and Broker-Dealers (File Nos. S7-07-18; S7-08-18; and S7-09-18)*

Dear Mr. Fields:

Invesco Advisers, Inc. (“Invesco”) is pleased to have the opportunity to comment on the Securities and Exchange Commission’s (the “Commission”) proposals regarding the standards of conduct for investment advisers and broker-dealers.¹ Invesco is a registered investment adviser that, along with its investment advisory and broker-dealer affiliates, advises and distributes more than 300 registered investment companies, including mutual funds, exchange-traded funds (“ETFs”) and closed-end funds, with combined assets as of May 31, 2018, of approximately \$454.2 billion. Invesco and its affiliates are indirect, wholly-owned subsidiaries of Invesco Ltd., a leading independent global investment management firm, with approximately \$963.3 billion in assets under management as of June 30, 2018. Invesco Ltd. manages assets across the globe through a wide range of investment strategies and vehicles, including mutual funds, closed-end funds, ETFs, unit investment trusts (“UITs”), collective trusts, separately managed accounts, real estate investment trusts, private funds and commodity pools, among others.

Invesco supports the Commission’s efforts to enhance protections for retail investors by bringing the legal requirements and mandated disclosures of investment professionals in line with investor expectations. We believe the Commission’s proposal may provide clarity to retail investors about investment professionals, enhance the standard of conduct for broker-dealers, and clarify the standards of conduct for investment advisers. For the first time, broker-dealers would be subject to a best interest standard for recommendations. We believe this best interest obligation will ensure broker-dealers place the interests of retail customers first and enhance investor confidence in investment professionals. In addition, Invesco commends the Commission’s principles-based approach, which recognizes how broker-dealers and investment advisers differ, and provides valuable flexibility to respond to how customers vary from each other and how the industry may change over time.

We appreciate the opportunity to offer insight on the Proposals’ impact to registered investment companies, distributors and investment advisers. Our comments — broadly speaking — are divided into two main parts. First, we request that the Commission provide a number of clarifications, and in certain cases consider changes to, the Best Interest and Disclosure Proposals. Second, we discuss our views on the Adviser Interpretive Proposal, including the enhancements the Commission has considered to the regulation of federally registered investment advisers. In this second part of our comments, we also recommend that the Adviser Interpretive Proposal reaffirm the Division of Investment Management’s guidance with respect to automated investment advice.

I. Executive Summary

The Commission has proposed a package of rules and interpretations designed to enhance quality and transparency in relationships between retail investors and their financial advisers, including broker-dealers and investment advisers. The Best Interest Proposal would adopt a new

¹ *Regulation Best Interest*, 83 Fed. Reg. 21574 (May 9, 2018), available at <https://www.gpo.gov/fdsys/pkg/FR-2018-05-09/pdf/2018-08582.pdf> (“Best Interest Proposal”); 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), available at <https://www.gpo.gov/fdsys/pkg/FR-2018-05-09/pdf/2018-08679.pdf> (“Adviser Interpretive Proposal”); 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), available at <https://www.gpo.gov/fdsys/pkg/FR-2018-05-09/pdf/2018-08583.pdf> (“Disclosure Proposal”), together with the Best Interest Proposal and Adviser Interpretive Proposal, collectively referred to as the “Proposals”).

Rule 15c-1 under the Securities Exchange Act of 1934 ("Exchange Act") that would establish a standard of conduct for broker-dealers and natural persons associated therewith when making a recommendation of any securities transaction or strategy involving securities to a retail customer. In addition, the Disclosure Proposal would adopt new Rule 17a-14 under the Exchange Act and Rule 204-5 under the Advisers Act to require broker-dealers and registered investment advisers to deliver a "relationship summary" (Form CRS) to retail investors. Invesco supports these proposals; however, we believe a number of issues should be clarified or reconsidered in the adoption of a final rule. Our comments, which are more fully discussed in this letter, are as follows:

- Invesco recommends adopting a standard of conduct that requires broker-dealers to place the interests of retail customers first.
- Invesco recommends clarifying that the fiduciary duty applies to discretionary recommendations made by broker-dealers.
- Invesco recommends clarifying when and how Regulation Best Interest applies to the recommendation of an account type and to recommendations involving "mixed" investments such as insurance products.
- Invesco requests guidance on how Regulation Best Interest relates to the existing suitability standard and state law and recommends that the Commission clarify the federal conduct standard preempts conflicting state law.
- Invesco recommends adopting a single definition of "retail customer" under the Best Interest and Disclosure Proposals.
- Invesco recommends that the Commission confirm broker-dealers are not required to separately disclose fund fees under the disclosure obligation.
- Invesco recommends clarifying Form CRS fee disclosures and delivery requirements (particularly as such requirements relate to limited-purpose broker-dealers that distribute shares of registered investment companies).
- Invesco recommends clarifying what constitutes a "material conflict of interest" and certain other aspects of the conflicts obligation set forth in the Best Interest Proposal.

In addition, Invesco believes that the Adviser Interpretive Disclosure should be enhanced and clarified prior to adoption. Specifically, we believe the Commission should (1) clarify the scope and applicability of an adviser's fiduciary duty as described herein; (2) revise the Adviser Interpretive Release's statements on disclosure and informed consent under the Investment Advisers Act of 1940, as amended ("Advisers Act"); and (3) reaffirm prior staff guidance on automated investment advice. In our comments to the Adviser Interpretive Disclosure, we also explain why it is not appropriate to regulate registered investment advisers in the same manner as broker-dealers at this time. Invesco also expresses strong support for the comments submitted under separate cover by the Investment Company Institute and the Security Industry Financial Markets Association.

II. Comments on the Best Interest and Disclosure Proposals

A. The Commission Should Adopt a Standard of Conduct that Requires Broker-Dealers to Place the Interests of Retail Customers First

Invesco strongly supports the Commission's proposal to adopt an express standard of conduct that requires broker-dealers to place the interests of retail customers first. The proposed best interest obligation would establish such a conduct standard by requiring a broker-dealer, when making a recommendation, to "act in the best interest of the retail customer at the time the recommendation is made without placing the financial or other interest of the [broker-dealer] . . . ahead of the interest of the retail customer." Under the Best Interest Proposal, the duty to act in a retail customer's best interest would be discharged if the broker-dealer complies with three primary obligations: (1) a disclosure obligation pursuant to which the broker-dealer must reasonably disclose the material facts relating to the scope and terms of the relationship; (2) a care obligation that requires, among other things, that a broker-dealer exercise reasonable diligence, care, skill and prudence in make a recommendation to a retail customer; and (3) a conflict of interest obligation pursuant to which broker-dealers must establish, maintain and enforce written policies and procedures reasonably designed to identify and address material conflicts associated with the recommendation or arising from financial incentives.²

We commend the Commission for raising the standard of conduct for broker-dealers when they provide recommendations to retail investors while preserving access (in terms of choice and cost) to a variety of types of investment services and products. We agree that the Best Interest Proposal, through each of the component obligations discussed above, is the appropriate framework for achieving the Commission's objectives. The Commission's principles-based approach recognizes that conflicts arising from financial incentives can be more effectively managed without adopting prescriptive standards that target only a narrow set of conduct. However, we have observed the concerns expressed by the Commission and believe that there are opportunities to enhance and clarify the "best interest" standard articulated in the proposed rule.³ Our specific recommendations are discussed below.

1. *The Commission should adopt a formulation of the "best interest" conduct standard that emphasizes the interests of the retail customer.*

The proposed best interest standard of conduct prohibits broker-dealers from placing their financial or other interests ahead of the interests of retail customers. We are concerned that this formulation of the "best interest" standard will not produce the desired outcome. Such a pointed emphasis on the broker-dealer's financial interests may encourage firms to devote a disproportionate amount of resources to conflicts related

² Best Interest Proposal at 21575.

³ Commissioner Robert J. Jackson, Jr., Public Statement: *Proposed Rulemakings Relating to Investment Adviser/Broker Dealer (IABD) Standards of Conduct* (April 18, 2018); Commissioner Hester M. Peirce, Public Statement: *Statement at the Open Meeting on Standards of Conduct for Investment Professionals* (April 18, 2018); Commissioner Kara M. Stein, Public Statement: *Statement on Proposals Relating to Regulation Best Interest, Form CRS, Restrictions on the Use of Certain Names or Titles, and Commission Interpretation Regarding the Standard of Conduct for Investment Advisers* (April 18, 2018).

to compensation practices to the detriment of others.⁴ In addition, the current formulation of the conduct standard does not offer a clear and positive “tone from the top.”⁵

To address this concern, we recommend that the Commission adopt the alternative formulation of the conduct standard set forth in the Best Interest Proposal. Specifically, we believe that a broker-dealer acts in the best interests of a retail customer *by placing the interest of the retail customer ahead of the broker-dealer*.⁶ The Commission’s alternative formulation sends a direct and clear message to broker-dealers and the public. By framing what it means to act in a retail customer’s “best interest” as described above, there will be no room for doubt as to what the “tone from the top” should be at brokerage firms across the United States: *Place the interest of the retail customer first*.

2. *The Commission should confirm that a broker-dealer is not required to recommend the lowest cost or “least remunerative” product.*

In the proposing release, the Commission stated that “cost (including fees, compensation and other financial incentives) associated with a recommendation would generally be an important factor” in determining whether a broker-dealer acted in the best interest of the retail customer.⁷ But a broker-dealer should also consider other factors in determining whether a recommendation is in a retail customer’s best interest.⁸ The proposing release nevertheless frames the discussion heavily in terms of fees and costs. We submit that cost is only one of many factors relevant to a recommendation. Other factors may include a product’s investment objectives, risk and return, product design, liquidity, volatility, the nature and quality of a provider’s services, minimum initial investments, firm reputation, convenience, and brand. We therefore recommend that the Commission clarify that broker-dealers are not required to place more weight on an investment’s cost (or the remuneration to the firm) than on any other factor that is material to the recommendation at hand.

We appreciate the statements in the Best Interest Proposal providing context for a broker-dealer’s consideration of costs as part of the care obligation.⁹ However, statements elsewhere in the Best Interest Proposal suggest costs and fees should be a primary focus of the best interest conduct standard. For example, the Best Interest Proposal states that when a broker-dealer recommends a more expensive security or investment strategy over another reasonably available alternative offered by the broker-dealer, the broker-dealer would need to have a reasonable basis to believe that the higher cost is justified (and thus nevertheless is in the retail customer’s best interest) based on other factors.¹⁰ In addition, as the Best Interest Proposal explains, when a broker-dealer recommends a more remunerative security or investment strategy over another reasonably available alternative offered by the broker-dealer, the broker-dealer would need to have a reasonable basis to believe that—putting aside the broker-dealer’s financial incentives—the recommendation was in the best interest of the retail customer based on the factors noted above, in light of the retail customer’s investment profile.¹¹

It also is unclear what the “lowest” cost product may be under certain circumstances, as it will depend on the other products to which it is compared, relevant holding periods, how fees and expenses change over time and potentially other considerations.¹² The resulting ambiguity about how a broker-dealer should consider costs and fees may cause broker-dealers, due to liability concerns, to gravitate to a small menu of low-cost, low-risk products that may not be adequate to meet the needs of the retail investor. In addition, we have strong concerns about a broker-dealer’s ability to demonstrate compliance with a requirement to recommend the “least expensive or least remunerative” option if all other factors are equal since such facts will be difficult or impossible to document.¹³

⁴ There is no doubt that the financial interests of broker-dealers are a source of potential conflicts of interest and of public interest. But the best interests of retail customers are not served merely because a broker subordinates its own financial or other interests to those of the retail client.

⁵ Indeed, the “tone from the top” could become resoundingly negative suggesting that broker-dealers should shift away from commission-based accounts, sell only the lowest cost products regardless of their benefits or marginalize pooled investment products with additional fees such as mutual funds in favor of direct investments in stocks and bonds.

⁶ Best Interest Proposal at 21591.

⁷ *Id.* at 21588.

⁸ *Id.*

⁹ For example, the proposing release notes that the care obligation would not require a broker-dealer to “recommend the least expensive or least remunerative security or investment strategy” and that the “cost associated with a recommendation is ordinarily only one of many factors to consider when evaluating the risks and rewards of a subject security or investment strategy involving securities.” *Id.* at 21609, 21610.

¹⁰ *Id.* at 21588 (citing factors such as the product’s or strategy’s investment objectives, characteristics, including any special or unusual features, liquidity, risks and potential benefits, volatility and likely performance in a variety of market and economic conditions).

¹¹ Proposed Rule 15l-1 would define “retail customer investment profile” to mean information, including, but not limited to, includes, but is not limited to, the retail customer’s age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the retail customer may disclose to the broker, dealer, or a natural person who is an associated person of a broker or dealer in connection with a recommendation. *See id.* at 21682.

¹² Since a recommendation is made as of a point in time, the statements in the Best Interest Proposal in this regard also raise concerns as to what the appropriate time frame will be in examining whether a broker-dealer’s conduct was consistent with the proposed conduct standard. It is unclear, for example, if a broker has the option to recommend two different mutual funds query whether the broker must consider whether any disclosed fee reductions will expire (or conversely will become effective) in the future. A potential requirement to consider forward-looking events is not limited to this example and gives us pause as to how a broker’s conduct will be evaluated in a market environment that is evolving constantly.

¹³ Applying these standards to any product or strategy that is more expensive or more remunerative will likely be unreasonably burdensome to comply with unless firms always recommend lowest cost or least remunerative option since in almost every instance there will be at least two reasonable alternatives with different fees and expenses. As with any purchase, whether the value offered by an investment or strategy justifies a higher cost is an inherently subjective judgment. It is for this very reason that retail customers seek the recommendation of a broker when making an investment decision.

3. *The final rule should explicitly provide that receipt of commission-based compensation does not in and of itself violate the best interest standard and that the best interest standard does not require a broker-dealer to have a continuing duty after providing a recommendation.*

Today, the Commission is proposing to adopt the Best Interest Proposal pursuant to Section 913(f) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, as may be amended from time to time (the "Dodd-Frank Act"). Section 913(f) of the Dodd-Frank Act authorizes the Commission to adopt rules as necessary or appropriate in the public interest and for the protection of retail customers (and such other customers as the Commission may provide), to address the regulatory standards of care for broker-dealers, among others. In addition, Section 913(g) of the Dodd-Frank Act authorizes the Commission to promulgate rules to provide that, with respect to a broker-dealer, when providing personalized investment advice about securities to a retail customer, the standard of conduct for the broker-dealer shall be the same as the standard of conduct under Section 211 of the Advisers Act.

We support the Commission's decision to promulgate the Best Interest Proposal pursuant to Section 913(f) of the Dodd-Frank Act.¹⁴ In so doing, however, the Best Interest Proposal does not incorporate the statutory safe harbors applicable to rules promulgated under Section 913(g) of the Dodd-Frank Act. Section 913(g) of the Dodd-Frank Act expressly provides, among other things, that the receipt of commission-based or other standard compensation for the sale of securities does not, in and of itself, violate the standard of care. In addition, Dodd-Frank Act Section 913(g) states that a broker-dealer is not required to have a continuing duty after providing personalized investment advice.

We believe that the Commission intended for the principles of Section 913(g) to apply in the context of the Best Interest Proposal.¹⁵ Accordingly, we recommend that any final rule explicitly incorporate the safe harbors under Dodd-Frank Act Section 913(g) related to commission-based compensation and a broker-dealer's continuing duty to its retail customers, among other policies expressed thereunder.

B. The Commission Should Clarify that the Advisers Act Fiduciary Duty Applies to Discretionary Recommendations

In proposing a "best interest" conduct standard for broker-dealers, the Commission has created a duty separate and distinct from the fiduciary duty that has developed under the Advisers Act.¹⁶ In our earlier comments, we express our support for the Commission's approach.¹⁷ However, the Commission has requested comment on whether firms will be able to ascertain when the "best interest" conduct standard applies as opposed to the fiduciary duty standard under the Advisers Act. We submit that the fiduciary duty standard under the Advisers Act should apply to any discretionary recommendation; therefore, the best interest conduct standard should be limited to non-discretionary recommendations by broker-dealers to retail customers.

Courts have held that brokers with discretion or control over customer assets or that have a relationship of trust and confidence owe customers a *fiduciary* duty.¹⁸ The courts' interpretation of the standards of conduct applicable to broker-dealers who exercise discretionary authority over customer accounts is consistent with the treatment of such conduct under the Advisers Act. Section 202(a)(11)(C) of the Advisers Act provides that an investment adviser does not include "any broker or dealer whose performance of [advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor."

We believe that discretionary investment management cannot be deemed to be "solely incidental" to brokerage services. The Commission requested a number of comments on this issue, including whether a broker-dealer's provision of limited or temporary discretionary advice should be considered solely incidental to the conduct of its business as a broker-dealer. Discretionary management over an account, whether or not temporary, is not within the scope of the "solely incidental" exclusion. Such conduct is indicative of the type of relationship of trust and confidence that should confer a fiduciary duty on a firm and we believe that retail investors should reasonably expect that all discretionary investment advice is subject to the fiduciary standard that was developed for this context.¹⁹

¹⁴ We believe that the uniform standard of care the Commission is authorized to adopt in accordance with Section 913(g) of the Advisers Act is impractical. We note that the standards of care would likely diverge since The Financial Industry Regulatory Authority ("FINRA") would primarily enforce the standard as applied to broker-dealers while the Commission would enforce the standard as applied to investment advisers.

¹⁵ See, e.g., Best Interest Proposal at 21586 (observing that the overall intent of Section 913 of the Dodd-Frank Act does not prohibit, mandate or promote particular types of products or business models, and intends to preserve investor choice among such services and products as well as how to pay for those services and products).

¹⁶ *Id.* at 21585.

¹⁷ See Section II.A beginning at p. 1.

¹⁸ See, e.g., *U.S. v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006) (fiduciary duty found "most commonly" where "a broker has discretionary authority over the customer's account"); *United States v. Szur*, 289 F.3d 200, 211 (2d Cir. 2002) ("Although it is true that there 'is no general fiduciary duty inherent in an ordinary broker/customer relationship,' a relationship of trust and confidence does exist between a broker and a customer with respect to those matters that have been entrusted to the broker.") (citations omitted); *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp. 951, 953-954 (E.D. Mich. 1978), *aff'd*, 647 F.2d 165 (6th Cir. 1981) (recognizing that a broker who has de facto control over non-discretionary account generally owes customer duties of a fiduciary nature; looking to customer's sophistication, and the degree of trust and confidence in the relationship, among other things, to determine duties owed).

¹⁹ The Commission has considered this issue multiple times. In 2005, the Commission adopted a rule relating to the broker-dealer exception in the Advisers Act stating that "exercising investment discretion is not 'solely incidental to' (a) the business of a broker or dealer within the meaning of the Advisers Act or (b) brokerage services within the meaning of the rule." See *Certain Broker-Dealers Deemed Not to be Investment Advisers*, Advisers Act Release No. 2340 (Jan. 6, 2005). In 2007 the Commission proposed an interpretive rule to clarify that "a broker-dealer that exercises investment discretion with respect to an account ... provides investment advice that is not 'solely incidental to' its business as a broker-dealer." The Commission explained that "[w]hen a broker-dealer exercises investment discretion, it is not only the source of investment advice, it also has the authority to make the investment decision relating to the purchase or sale of securities on behalf of its client." See *Interpretive Rule Under the Advisers Act Affecting Broker-Dealers*, Investment Advisers Act Release No. 2652 (Sept. 24, 2007) (vacated).

C. The Commission Should Clarify When and How Regulation Best Interest Applies to the Recommendation of an Account Type and Recommendations Involving “Mixed” Investments

Proposed Regulation Best Interest would not apply to the recommendation of an account type generally, unless the recommendation is tied to a securities transaction (e.g., to roll over or transfer assets such as IRA rollovers).²⁰ The Commission requests comment on this issue because the standard of conduct that would apply to the recommendation of an account type may raise complex issues, especially for dual registrants. Given the significant implications of this choice for retail investors, we suggest that the Commission provide more clarity as to which standard of conduct would apply to the recommendation of an account type (particularly by a dual registrant), and when it would apply. We note that this decision is relevant not only for retail investors making an initial choice of which account type may be most appropriate to execute their investment strategy, but for those investors who already hold securities in an account and receive a recommendation to convert that account to a different type of account. In addition, we recommend that the Commission provide guidance on how Regulation Best Interest would apply to advice concerning “mixed” transactions such as a recommendation to purchase an insurance product (other than a variable annuity or variable life insurance policy) in lieu of, or by selling, a security.²¹ We note that this sort of advice implicates not only conduct standards applicable to brokers under federal law but also conduct standards that apply to such transactions under state law. We further recommend that the Commission provide guidance as to how brokers should apply the disclosure obligation, care obligation and conflict of interest obligation in such circumstances.

D. The Commission Should Provide Guidance on How Regulation Best Interest Relates to the Existing Suitability Standard and State Law

The Best Interest Proposal states that it is not intended to amend or eliminate brokerage firms’ existing obligations under the securities laws including the “suitability” standard that derives from the antifraud provisions of the federal securities laws.²² If Regulation Best Interest were adopted today, it is unclear how FINRA would apply this new conduct standard relative to the existing suitability obligations. In particular, there is uncertainty as to whether FINRA will seek to change its existing rules to conform to the new “best interest” standard of conduct, whether both standards of conduct would apply and if so whether it would be possible to violate Regulation Best Interest but not the suitability standard (or vice versa) or whether the suitability standard would be completely subsumed into the best interest obligation. We therefore urge the Commission to provide guidance with respect to the harmonization of Regulation Best Interest and existing regulations in adopting any final rule.

We also urge the Commission to explicitly clarify that the new best interest standard will be the exclusive standard of conduct for broker-dealers registered under the Exchange Act and that the fiduciary duty standard, as reflected in Section 206(1) and (2) of the Advisers Act is the exclusive standard of conduct for registered investment advisers. In particular, we recommend that the Commission affirm, consistent with Sections 15(j) of the Exchange Act and Section 203A of the Advisers Act, that the Commission’s standards of conduct would preempt any standards under state law that are inconsistent with federal law.²³ The potential for differing standards of conduct at the state level could result in a patchwork of confusing and burdensome requirements for firms engaged in interstate commerce and inconsistent protections for investors. Alternatively, the Commission should work closely with state regulators, including those charged with oversight of the securities, banking and insurance industries, to ensure that any standards of conduct applicable under state law are consistent with Regulation Best Interest.

E. The Commission Should Adopt a Single Definition of “Retail Customer” under the Proposals

Proposed Regulation Best Interest defines the term “retail customer” as “a person, or the legal representative of such person, who: (1) 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 (2) uses the recommendation primarily for personal, family, or household purposes.”²⁴ By contrast, the Disclosure Proposal defines the term “retail investor” for purposes of Form CRS as “a prospective or existing client or customer who is a natural person (an individual). This term includes a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust.”²⁵ The Commission requests comment on whether it should use the definition of “retail investor” for purposes of both rulemakings. We believe it should.

The definition of “retail investor,” which is limited to natural persons, is more consistent with the Commission’s focus in these proposals on individuals. Using the definition of “retail investor” in both rules would also provide important administrative efficiencies, facilitate compliance, and avoid confusion without undermining the regulatory objectives under the proposals.

The Best Interest Proposal states that the definition of “retail customer” would include participants in ERISA-covered plans and IRAs.²⁶ We agree, and believe the definition of “retail investor” in proposed Form CRS similarly would include participants in such plans and IRAs. We urge the Commission to revise the definition of “retail investor” to be used for purposes of both Regulation Best Interest and Form CRS to explicitly include participants in ERISA-covered plans and IRAs. Treating these investors as “retail investors” for purposes of Regulation Best

²⁰ Best Interest Proposal at 21595.

²¹ It may also be appropriate for the Commission to provide more explicit guidance on transactions involving variable annuities and variable life insurance products and their underlying investment options more generally as these insurance products are regulated both under the federal securities laws and under state insurance laws. We note that there may be an irreconcilable conflict in terms of the applicable standard of conduct. See, e.g., McCarran-Ferguson Act [15 U.S.C. §§ 1011-1015]. In addition, we understand that certain insurers issue hybrid products known as “indexed annuities” that may or may not be securities under certain circumstances. In the absence of guidance from the Commission, we believe that recommendations related to these transactions may not be applied consistently across the industry.

²² Best Interest Proposal at 21599.

²³ See 15 U.S.C. § 780(i) (establishing limitations on state law with respect to certain obligations applicable to broker-dealers); see also 15 U.S.C. § 80b-3a (establishing federal and state responsibilities for the regulation of investment advisers).

²⁴ Best Interest Proposal at 21682.

²⁵ Disclosure Proposal at 21548.

²⁶ Best Interest Proposal at 21598.

Interest is critical to realizing one of the key benefits of the Commission's rulemaking – providing consistent protections to retail brokerage customers. The adoption of a strong best interest standard for broker-dealers that applies to investors in both retail and retirement accounts will provide the necessary basis for the Department of Labor (“DOL”) to adopt a new, streamlined prohibited transaction exemption for financial professionals that are subject to the best interest standard of conduct. This result would benefit retail investors by subjecting broker-dealers to a consistent standard of conduct when they provide recommendations to retail investors, whether those investors are saving for retirement or other goals.

We also recommend that the Commission clarify explicitly that a “legal representative” of a natural person should not include a bank, registered broker-dealer, registered investment adviser, insurance company, or other financial institution or intermediary that is responsible for exercising independent judgment in evaluating the recommendation. It is unnecessary to subject recommendations that a broker-dealer makes to these regulated intermediaries to the best interest standard, or for such intermediaries to receive a Form CRS, when they are exercising independent judgment in evaluating the recommendation. Alternatively, the Commission should clarify that Regulation Best Interest applies to the legal representative of a natural person only if the broker-dealer knows that its recommendation will be used primarily for personal household or family purposes. In the absence of such knowledge, the applicable standard of conduct may not always be clear to a broker dealing with institutions representing the interests of natural persons.

The Best Interest Proposal is silent with respect to whether it would apply to discussions between broker-dealers and representatives of employer-sponsored retirement plans. By plan “representative” we mean to refer not only to the plan's fiduciaries (who determine the investments and administer the plan), but also to the variety of other entities and professionals charged with designing the plan and advising the plan fiduciaries, including the sponsoring employer and the plan's consultants and advisers. While we do not believe the Commission intended to extend Regulation Best Interest to recommendations from a broker-dealer to a representative of an employer-sponsored retirement plan, the Commission should provide express confirmation of this position.²⁷

F. The Commission Requests Comment on the Scope of “Recommendation” under Regulation Best Interest

1. *The Commission should clarify that certain educational- and retirement-related communications do not constitute “recommendations” for purposes of Regulation Best Interest.*

Regulation Best Interest would require broker-dealers to satisfy a new set of obligations when making a “recommendation” of any securities transaction or investment strategy involving securities to a retail customer. Although Regulation Best Interest, as proposed, does not define the term “recommendation,” the Commission proposes to interpret the term consistent with FINRA rules and broker-dealer regulations generally.²⁸ To ensure that broker-dealers continue to provide valuable information to their retail customers, Invesco urges the Commission to expressly clarify that certain conversations regarding investor education and retirement accounts, among others, do not involve a “recommendation of any securities transaction or investment strategy involving securities.” While we believe the Commission's proposal and current FINRA guidance should not implicate many of these communications, we believe information and materials that, without reference to the appropriateness of any individual investment alternative or strategy, describe the terms an investment or strategy or the operation of a retirement plan or IRA, or otherwise provide advice primarily intended to help investors understand an investment or investment strategy should be expressly excluded from the rule. We believe that this will ensure Regulation Best Interest does not discourage broker-dealers in any way from having these important conversations with retirement investors.

2. *The Commission should clarify that broker-dealers are not required to periodically evaluate whether an initial recommendation remains appropriate.*

As discussed above in Section II.A.3, we believe that the Commission intended to incorporate the provisions of Section 913(g) of the Dodd-Frank Act (stating that the conduct standard need not require ongoing duties) into Regulation Best Interest. Invesco believes that whether a broker-dealer has a responsibility to periodically evaluate whether an initial recommendation remains appropriate is an arrangement that should be left to agreement between the broker-dealer and its retail customer and submits that such an approach is consistent with the proposition that Regulation Best Interest applies to a recommendation and not to account types generally. Moreover, as discussed above in Section II.B, a requirement to provide ongoing or periodic recommendations subsequent to the initial recommendation raises questions as to whether such conduct is within the scope of the Advisers Act and therefore within the ambit of the fiduciary standard.

G. Invesco Recommends that the Commission Confirm Broker-Dealers Are Not Required to Separately Disclose Fund Fees under the Best Interest Disclosure Obligation

The stated goal of Regulation Best Interest's disclosure obligation is to make the customer aware of “certain key information regarding [the customer's] relationship with the broker-dealer.”²⁹ The focus is on the scope and terms of the relationship, and the incentives the broker-dealer may have. Consistent with this focus, we request confirmation that a broker-dealer would not be required by the proposed disclosure obligation to separately disclose fees and expenses related to specific products, such as registered investment companies or other pooled investment vehicles, including private funds. Instead, we believe a broker-dealer should be required to disclose the fees and expenses associated with its services, disclose the types of fees and expenses associated with the products that it recommends, the fees it receives relating to the customer's investment, and refer the customer to product-level disclosures for more information about the product's specific fees and expenses. Thus, for a registered investment company or private fund, a broker-dealer should be permitted to direct customers to the prospectus or private placement memorandum as the source of detailed information about fees and expenses. We do not believe the broker-

²⁷ To be a “retail customer” for purposes of Regulation Best Interest, a person receiving a recommendation must use “the recommendation primarily for personal, family, or household purposes.” We note this threshold requirement should exclude retirement plan representatives from the definition of “retail customer” because retirement plan representatives do not use broker-dealer recommendations “primarily for personal, family, or household purposes.” Rather, plan representatives use recommendations for the benefit of the plan and its participants by selecting a menu of investments for participant-directed accounts.

²⁸ Best Interest Release at 21592.

²⁹ *Id.* at 21599.

dealer is in the best position to disclose information about the fees the fund charges and note that registered investment companies are already are subject to comprehensive, standardized fee disclosure obligations in their prospectuses.

H. Invesco Recommends Clarifying Form CRS Fee Disclosures and Delivery Requirements

Proposed Form CRS requires broker-dealers to summarize the principal fees and costs that retail investors will incur. The Commission proposes prescribed language that describes the transactional nature of many brokerage fees. We request that the Commission revise these descriptions to make them more product agnostic and to better clarify how different types of fees would affect an investment.³⁰

1. *The Form CRS Disclosures should be more product agnostic.*

Form CRS includes prescribed disclosure that describes the types of transaction-based fees that broker-dealers may charge. The Commission indicated that it believes investors would benefit from specific examples of transaction-based fees and gives two examples of transaction-based fees—bond mark-ups/mark downs and mutual fund sales loads. The Commission proposes requiring firms to include mutual fund loads as an example “because they are common indirect fees associated with investments that compensate the broker-dealer.”³¹

We recommend that Form CRS instead provide a bulleted list of examples of transaction-based fees, and a broad statement that transaction fees “increase the cost of your investment.” Providing a list with several examples would increase the likelihood that an investor will be able to recognize a transaction-based fee and request more information from his or her financial representative. A list approach also would be more product agnostic and would avoid giving investors the impression that fees on products other than bonds and mutual funds are less worthy of scrutiny. To ensure that the list of examples is relevant to the customer, the Commission could consider permitting a broker-dealer to provide examples of transaction-based fees most applicable to its business and the products that it offers.

2. *The Form CRS disclosures should prompt investors to inquire about types and levels of fees rather than personalized fee disclosure.*

Form CRS includes two separate prompts for investors to ask their broker-dealer or adviser for personalized fee information—in the “Fees and Costs” section and in the “key questions” at the end of the Form. We are concerned that estimating individualized costs at this juncture would not result in meaningful figures. It is unclear how financial professionals would generate accurate personalized fee disclosure during the initial meeting with a new investor, potentially before receiving complete information on the customer’s investments, financial circumstances and investment objectives, and before making any recommendations of a security or investment strategy. To predict forward-looking fees, a financial professional would need to determine an investor’s risk tolerance, time horizon, and other preferences, and then forecast the types of investment products in an investor’s account as well as the likely frequency of trading. Such personalized fee disclosures may mislead or confuse investors since the relevant facts needed to make such estimates are not reasonably available.

We recommend the Form CRS disclosure focus investors on asking their financial professional about types and levels of fees associated with each type of account as opposed to a detailed personalized estimate of prospective fees that is likely to be costly and inaccurate. More detailed fee information would be available through the layered disclosure framework that the Commission has proposed under the disclosure obligation. We believe this approach would be better suited to the objective of using Form CRS to help investors decide which account type is best for their needs.

In addition, we request that the Commission clarify that the disclosure obligation under the Best Interest and Disclosure Proposals do not require point-of-sale disclosures. We do not believe such an interpretation of the disclosure obligation is appropriate. Such disclosures would not be useful to investors because investors could not gauge the magnitude of any differences among the products.³² In addition to the operational challenges such an interpretation would create, such disclosures may result in investor confusion by suggesting higher cost products are *de facto* against their best interest.

3. *The Commission should clarify that delivery of Form CRS is unnecessary for limited-purpose broker-dealers under certain circumstances.*

We recommend that the final rule exclude a registered investment company’s limited-purpose broker-dealer from Form CRS delivery requirements since it is not providing investment advice. When a fund transfer agent receives a new account application (*i.e.*, “check and application”) that does not designate a third-party intermediary, the transfer agent may list or otherwise associate the fund’s limited-purpose broker-dealer as a “default” for the account. The fund’s limited-purpose broker-dealer also may be designated on a customer’s account in the case where an outside broker-dealer resigns as broker of record for that account.

In either of these instances, the investor is not receiving recommendations or advice from the fund’s limited-purpose broker-dealer. A fund’s limited-purpose broker-dealer is not providing a recommendation to the investor and therefore would fall outside of the scope of Regulation Best Interest. But the proposal would require delivery of Form CRS even though disclosure is unnecessary in this scenario. In the alternative, the we recommend that the final rule exclude from Form CRS delivery requirements a fund’s limited-purpose broker-dealer that is not receiving any compensation for investor accounts on which it may be the broker-dealer of record. Form CRS is designed to help an investor understand the differences between financial services received from a broker-dealer or investment adviser, including the applicable standard of conduct,

³⁰ As discussed elsewhere in our comments, we request that the Commission confirm that the prospectus or other offering document for a fund remain the sole source of information concerning the fees and expenses of those products.

³¹ Disclosure Proposal at 21433.

³² Although we believe that hypothetical or personal fee disclosures will likely create confusion, if the Commission were to require disclosures of this sort, to reduce confusion, such disclosures should focus on helping investors understand the effect expenses have on an investment. Such disclosure could be achieved – for example – by a side-by-side bar graph showing the growth of an investment gross of costs and net of costs. To ensure investors understand that this sort of disclosure is educational, disclosures would have to accompany the presentation explaining, among other things, that the investment could represent an investment in any sort of security or portfolio of securities and that the expenses may be comprised of a variety of fees and expenses.

types of fees charged, and scope of the relationship. There is no policy need for the fund's limited-purpose broker-dealer to deliver Form CRS when it is not providing recommendations to the investor.

I. Invesco Recommends Clarifying What Constitutes a Material Conflict of Interest and Certain Other Aspects of the Conflicts Obligation

Regulation Best Interest's conflict of interest obligations would require a broker-dealer to establish, maintain, and enforce written policies and procedures reasonably designed to (1) identify and at a minimum disclose, or eliminate, all material conflicts of interest associated with such recommendations; and (2) identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations. The conflict of interest obligation would create a broad new duty for broker-dealers to mitigate material conflicts of interest arising from financial incentives. It is unclear, however, which conflicts a broker-dealer would be required to mitigate and how. As discussed in more detail below, we recommend clarifying what is a "material conflict of interest" and revising the proposed conflict of interest obligations to require that a broker-dealer firm establish, maintain and enforce written policies and procedures reasonably designed to (i) identify and disclose material conflicts of interest associated with a recommendation, and (ii) mitigate, or eliminate, those material conflicts of interest associated with the recommendation that create a financial incentive for the associated person of the broker-dealer to put its interests ahead of the retail customer's interests.

1. The Commission should clarify that whether a conflict of interest is "material" should be evaluated based on objective criteria.

The Best Interest Proposal interprets the term "material conflict of interest" to mean "a conflict of interest that a reasonable person would expect might incline a broker-dealer—consciously or unconsciously—to make a recommendation that is not disinterested."³³ The intention of this interpretation is to be consistent with the concept of material conflicts of interest under the Advisers Act; however, we believe the Commission has inadvertently proposed a standard that is subjective and inconsistent with existing Advisers Act principles. Rather than focusing on what "a reasonable person would expect might incline a broker-dealer" to do, the standard should instead reflect existing, objective concepts of materiality and material conflicts of interest. Under the federal securities laws, information is material where there is a substantial likelihood that a reasonable investor would have considered the information important.³⁴ Under the Advisers Act, a conflict of interest arises if an incentive exists that "might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested."³⁵ Thus, we recommend that "conflict of interest" be interpreted to be consistent with how that term is defined under the Advisers Act. In addition, such a conflict of interest should be considered "material" if there is a substantial likelihood that a reasonable investor would consider the information important.

2. The Commission should more clearly distinguish the duty to mitigate from the duty to disclose.

The Best Interest Proposal is unclear as to what would constitute a "material conflict of interest arising from financial incentives" that would be subject to mitigation or elimination, as compared to a material conflict that would be subject to disclosure or elimination. The Best Interest Proposal states that its intent regarding the proposed conflict of interest obligation was to address the same concerns regarding conflicts as the DOL fiduciary rule "in a less prescriptive manner."³⁶ We believe, however, that without further clarification or modification, the proposed mitigation obligation may be more extensive than the requirements of the DOL fiduciary rule. In addition, we are concerned that the proposed formulation of the duty to mitigate or eliminate or to disclose creates considerable uncertainty for broker-dealers. For example, if a broker chooses to disclose, rather than eliminate, a material conflict of interest, broker-dealers would have to justify this choice. Similarly, for a material conflict related to a financial incentive, the choice to mitigate or eliminate the conflict begs the question as to why the firm chose one over the other.

To address these concerns, we recommend the Commission revise its proposed conflict of interest obligations to require a broker-dealer firm to establish, maintain and enforce written policies and procedures reasonably designed to (i) identify and disclose material conflicts of interest associated with a recommendation, and (ii) mitigate, or eliminate, those material conflicts of interest associated with the recommendation that create a financial incentive for the associated person of the broker-dealer to put its interests ahead of the retail customer's interests. This would focus the mitigation obligation on fees, revenue, or other financial incentives that may influence the recommendation of a broker-dealer representative – the individual making the recommendation. By contrast, a broker-dealer (like an investment adviser) could address conflicts at the firm level through disclosure without necessarily being subject to an obligation to otherwise mitigate or eliminate a material conflict of interest, if the material conflict does not otherwise result in a material financial incentive to the broker-dealer representative making the recommendation. This approach is consistent with the approach the DOL took in the fiduciary rule and appears to be consistent with the Commission's intent.

In clarifying the scope of the proposed mitigation obligation, we also recommend that the Commission modify or omit from any final rule release some of the statements and examples in the Best Interest Proposal to avoid confusion. For example, the Best Interest Proposal includes in its list of possible financial incentives associated with a recommendation "both sales compensation and compensation that does not result from sales activity, such as compensation for services provided to third-parties (e.g., sub-accounting or administrative services provided to a mutual fund)."³⁷ We agree that third-party compensation to a broker-dealer representative could create a financial incentive to recommend one security over another, but fees paid to a broker-dealer firm for providing services that otherwise would need to be provided by another party should not automatically be considered to create a financial incentive for the representative to put its interests ahead of the retail customer's interests.

³³ Regulation Best Interest Proposal at 21602; See also, *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-92, 194 (1963).

³⁴ See *Basic v. Levinson*, 485 U.S. 240 (1988) (materiality depends on the significance a reasonable investor would place on the withheld or misrepresented information).

³⁵ *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

³⁶ Regulation Best Interest 21622.

³⁷ *Id.* at 21618.

3. *The Commission Should Clarify the Best Interest Proposal's Statements About "Otherwise Identical" Securities and "Reasonably Available Alternatives"*

The Best Interest Proposal states that, under the proposed care obligation, a broker-dealer could not have a reasonable basis to believe that a recommended security is in the best interest of a retail customer if it is more costly than a reasonably available alternative offered by the broker-dealer and the characteristics of the securities are otherwise identical, including any special or unusual features, liquidity, risks and potential benefits, volatility and likely performance.³⁸ The proposal explains that if a broker-dealer recommends a more expensive security or investment strategy over another reasonably available alternative the broker-dealer offers, it needs to have a reasonable basis to believe the higher cost is justified and is in the customer's best interest, in light of the customer's investment profile. Neither of these terms is defined, and we are concerned that in the absence of clarification, the Commission's statements in the Best Interest Proposal could result in unintended consequences for investors.

It is unclear what "otherwise identical securities" are given it is rare that two securities would be completely identical aside from their costs. We request that the Commission clarify how a broker-dealer analyze whether two securities are "otherwise identical."³⁹ For example, this concept could require a broker-dealer to recommend the lowest cost option of two funds or the lowest cost option between a fund and a direct investment in stocks and bonds. We do not believe this was the intent.

In addition, the Best Interest Proposal refers to "reasonably available alternatives offered by the broker-dealer," but it is unclear what it means for alternatives to be "reasonably available." In this context, we believe a "reasonably available alternative" should mean an alternative investment offered by the broker-dealer that would satisfy the broker-dealer's reasonable basis obligations under the proposed care obligation. We therefore urge the Commission to clarify these references.

III. Comments on the Adviser Interpretive Proposal

We appreciate the Commission's proposal reaffirm and clarify its views of the fiduciary duty that investment advisers owe to their clients. We agree there are benefits to having a clear statement regarding the fiduciary duty that applies to an investment adviser, and the obligations flowing from that duty that are enforceable under Section 206(1) and (2) of the Advisers Act. Before adopting any final interpretation, however, we urge the Commission to revise the interpretation so that it is more consistent with common law principles that historically have governed interpretation of an adviser's fiduciary duty. In addition, we believe that the Commission should clarify how the Adviser Interpretive Proposal applies to automated advisers ("robo-advisers").

A. The Commission Should Clarify the Scope and Applicability of an Adviser's Fiduciary Duty

We recommend that the Adviser Interpretive Proposal more clearly recognize that under common law, the specific obligations that flow from an adviser's fiduciary duty depend on the scope of the relationship agreed to by the adviser and client. The Adviser Interpretive Proposal states: "[a]lthough the ability to tailor the terms means that the application of the fiduciary duty will vary with the terms of the relationship, the relationship in all cases remains that of a fiduciary to a client."⁴⁰ But the proposal also makes broad statements about an adviser's fiduciary duty that do not sufficiently reflect that fiduciary obligations stemming from the duties of loyalty and care vary depending on the scope of the relationship agreed to with the client.

We request that the Commission acknowledge that there may be differences in how an adviser's fiduciary duty obligations apply in institutional relationships and in relationships with robo-advisers to ensure that any final interpretation appropriately reflects such differences. As an example, an adviser to an institutional client, such as a subadviser to a registered fund, has a duty of care to that client, but the concept of a periodically updated "investment profile" does not apply in that context. Rather, a subadviser to a registered fund would provide advice based on the terms of the subadvisory agreement and the fund's investment objectives. The variety of advisory relationships and models that exist, including institutional mandates that may be more limited or specific, we believe this is an overly broad statement of law. The extent of an adviser's advice and any duty to monitor are established by agreement between the adviser and the client.

B. The Commission Should Revise the Interpretive Release's Statements on Disclosure and Informed Consent under the Advisers Act

Adviser Interpretive Proposal explains that "an adviser must provide the client with sufficiently specific facts so that the client is able to understand the adviser's conflicts of interest and business practices well enough to make an informed decision."⁴¹ The proposal explains that a client's informed consent to an adviser's disclosure may be explicit or implicit, depending on the facts and circumstances. The Commission asserts, however, that, "it would not be consistent with an adviser's fiduciary duty to infer or accept client consent to a conflict where either (i) the facts and circumstances indicate that the client did not understand the nature and import of the conflict, or (ii) the material facts concerning the conflict could not be fully and fairly disclosed."⁴² The Commission also asserts that "[d]isclosure of a conflict alone is not always sufficient to satisfy the adviser's duty of loyalty and section 206 of the Advisers Act."⁴³ To the extent these statements might suggest or be misconstrued to suggest that disclosure and informed consent are insufficient as a matter of law to satisfy an adviser's fiduciary duty of loyalty, we urge the Commission to confirm that full and fair disclosure of material conflicts and informed consent, which may be provided implicitly or explicitly depending on the circumstances, is the existing standard under common law and the Advisers Act.

³⁸ *Id.* at 21588.

³⁹ It is difficult to envision how two securities could be identical unless such securities were different share classes of the same mutual fund.

⁴⁰ Adviser Interpretive Proposal at 21205.

⁴¹ *Id.* at 21209.

⁴² *Id.* (remarking that in some cases, conflicts may be of a nature and extent that it would be difficult to provide disclosure that adequately conveys the material facts or the nature, magnitude and potential effect of the conflict necessary to obtain informed consent and satisfy an adviser's fiduciary duty. In other cases, disclosure may not be specific enough for clients to understand whether and how the conflict will affect the advice they receive).

⁴³ *Id.* at 21208.

C. The Commission Should Not Impose the Broker-Dealer Regulatory Regime on Investment Advisers

The Commission requests comment on three potential enhancements to advisers' existing fiduciary obligations: (1) licensing and continuing education requirements for personnel of registered investment advisers; (2) delivery of account statements to clients with investment advisory accounts; and (3) financial responsibility requirements for registered investment advisers, including fidelity bonds. We understand that the Commission may issue proposed rules on these potential enhancements in the future. However, we submit that such proposals should be the subject of separate rulemaking. We discuss our concerns with the Commission's proposal in the following sections.

1. Federal Licensing and Continuing Education Requirements

The Commission notes that FINRA imposes registration and qualification requirements on associated persons of broker-dealers, including a qualification exam and continuing education requirements. The Commission requests comment on whether there should similarly be federal licensing and continuing education requirements for personnel of registered investment advisers. We believe that existing licensing and qualification requirements under state law address the Commission's concerns.

Most states regulate investment adviser representatives and require their registration. Regardless of the state, state registration as an investment adviser representative typically consists of filing a standardized Form U-4, Uniform Application for Securities Industry Registration, with the state through the Investment Adviser Registration Depository, and passing a qualification exam, such as the Series 65 exam developed by the North American Securities Administrators Association ("NASAA").⁴⁴

We strongly recommend that the Commission consider the regulatory requirements that are already in place under state law before proceeding with rulemaking in this area. The Commission should also be cognizant that the infrastructure to implement a new registration and examination regime for investment adviser representatives does not exist at the federal level, and creating such an infrastructure would raise a host of issues (including resource issues) that are beyond the scope of the Commission's current request for comment.⁴⁵

2. Quarterly Account Statements

Broker-dealers generally must provide account statements to clients at least once every calendar quarter. The Commission requests comment on whether registered investment advisers should be required to provide investors with account statements to allow them to easily see and understand the fees and expenses they pay for the adviser's services. We believe this requirement is adequately addressed under existing law.

For example, investors who acquire shares of registered investment companies through advisory accounts receive at least quarterly account statements regarding their investment from the broker-dealer, bank or transfer agent through which their investment is held. Requiring advisers to separately provide quarterly account statements would be duplicative.

In addition, investment advisers are themselves required to ensure their clients receive account statements. Separately managed account programs relying on the safe harbor from investment company registration under the Investment Company Act of 1940, as amended (the "1940 Act"), must ensure each client is provided with a quarterly account statement containing a description of all activity in the client's account as a condition of reliance on the safe harbor.⁴⁶ Investment advisers with custody of client assets are also required to have a reasonable basis to believe the "qualified custodian" that holds the assets sends an account statement to the investor at least quarterly.⁴⁷ We also note that mutual funds and other registered investment companies must send shareholders semi-annual and annual reports that include information regarding fees and expenses borne by shareholders during the applicable reporting period.⁴⁸

3. Financial Responsibility Requirements

Broker-dealers are subject to strict requirements regarding minimum capital and segregation under the Exchange Act.⁴⁹ These and other broker-dealer obligations are intended to ensure that customer assets are protected and available in the event the firm fails. The Commission requests comment on whether registered investment advisers should be subject to financial responsibility requirements like those that apply to broker-dealers. We believe such a requirement would be largely duplicative of existing requirements.

Investment advisers to registered investment companies, unlike broker-dealers, are not permitted to have custody of client assets.⁵⁰ Instead, under the 1940 Act, fund portfolio assets must be held in a custody arrangement meeting the requirements of Section 17(f) of the 1940 Act and related rules.⁵¹ In addition, investment advisers to registered investment companies are subject to fidelity bonding requirements under the 1940 Act, and strict regulations concerning transactions between such companies and their affiliated persons, including investment advisers.⁵²

⁴⁴ See, e.g., Chapter 116, Part 7, Title 7 of the Texas Administrative Code §§ 116.1 et seq. (application, examination and other requirements applicable to investment advisers and investment adviser representatives).

⁴⁵ Such issues would also include how such licensing requirements would apply to robo-advisers.

⁴⁶ Rule 3a-4 under the 1940 Act [17 C.F.R. § 270.3a-4].

⁴⁷ Rule 206(4)-2 under the Advisers Act [17 C.F.R. § 275.206(4)-2].

⁴⁸ See Section 30(e) of the 1940 Act [15 U.S.C. § 80a-29]; Rule 30e-1 under the 1940 Act [17 C.F.R. § 270.30e-1].

⁴⁹ See, e.g., Rule 15c3-1 under the Exchange Act [17 C.F.R. § 240.15c3-1].

⁵⁰ See Section 17(f) of the 1940 Act [15 U.S.C. § 80a-17(f)]. Self-custody for registered investment companies is permitted under extremely limited circumstances. See Rule 17f-2 under the 1940 Act [17 C.F.R. § 270.17f-2]. Such arrangements are subject to numerous safeguards, including a requirement that the investments be verified by actual examination by an independent public accounting at least three times during each fiscal year (two such examinations are to be "surprise" exams).

⁵¹ *Id.*

⁵² *Id.* at § 17(f), (g).

D. The Commission Should Reaffirm the IM Guidance Update on Robo-Advisers

In IM Guidance Update No. 2017-02, the staff of the Division of Investment Management provided industry guidance focused on so called “robo-advisers” that rely on algorithms or other automated methods to provide investment advice (typically over the internet) to customers.⁵³ Because robo-advisers rely on algorithms to provide investment advisory services, robo-advisers offer varying levels of human interaction. Robo-advisers, if registered with the Commission under the Advisers Act, are subject to all of the requirements of the Advisers Act, including the requirement that they provide advice consistent with the fiduciary duty they owe to their clients.⁵⁴ Therefore, the Adviser Interpretive Proposal would, if adopted, apply to robo-advisers as to any other registered investment adviser.⁵⁵ The Adviser Interpretive Proposal, however, does not offer insight into how these principles would apply to a robo-adviser’s business model, and certain statements made therein raise concerns for automated investment advice generally.⁵⁶ For this reason, we ask that the Commission expressly adopt and reaffirm the staff’s guidance in any final interpretive release, or alternatively, to clarify and revise the Adviser Interpretive Release’s statements as applicable to robo-advisers.

One statement in the Adviser Interpretive Proposal of particular concern to robo-advisers is the assertion that an investment adviser must “have a *reasonable belief* that the personalized advice is suitable for and in the best interest of the client” (emphasis added).⁵⁷ The staff observed in the 2017 IM Guidance that robo-advisers provide investment advice base primarily, if not solely, on client responses to questionnaires.⁵⁸ These responses are then interpreted through a sophisticated mathematical formula or algorithm to make a recommendation to a client. The algorithm can only accept objective information and can only make recommendations based on pre-established criteria. It cannot formulate any sort of “belief” concerning the suitability of the advice as it pertains to a particular client.

In the 2017 IM Guidance, the staff recommended that, when human interaction is limited, that robo-advisers focus on whether its questionnaire is designed to elicit sufficient information to support its suitability obligation. The staff further recommended that robo-advisers consider some or all of the following facts in making its determination:

- Whether the questions elicit sufficient information to allow the robo-adviser to conclude that its initial recommendations and ongoing investment advice are suitable and appropriate for that client based on his or her financial situation and investment objectives;
- Whether the questions in the questionnaire are sufficiently clear and/or whether the questionnaire is designed to provide additional clarification or examples to clients when necessary (e.g., through the use of design features, such as tool-tips or popup boxes); and
- Whether steps have been taken to address inconsistent client responses, such as (1) incorporating into the questionnaire design features to alert a client when his or her responses appear internally inconsistent and suggest that the client may wish to reconsider such responses; or (2) implementing systems to automatically flag apparently inconsistent information provided by a client for review or follow-up by the robo-adviser.⁵⁹

We believe that the staff’s approach in the 2017 IM Guidance is the appropriate framework for assessing whether automated investment advice has satisfied the applicable standard of conduct. We therefore urge the Commission to clarify that – in the context of automated investment advice – that the investment adviser must have a reasonable belief that the algorithm is sufficiently robust to collect enough data to apply its rules effectively.

Another concern raised by the Adviser Interpretive Proposal is the statement that “cost (including fees and compensation) associated with investment advice would generally be one of many important factors . . . to consider when determining whether a security or investment strategy involving a security or securities is in the best interest of the client.”⁶⁰ The proposal suggests, consistent with the Best Interest Proposal, that the adviser is not required to recommend the lowest cost or least remunerative product or strategy but must have a “reasonable belief” that the higher cost or more remunerative product or strategy is in the client’s best interest.

We are concerned that such statements – in isolation – could affect how robo-advisers operate. Robo-advisers can offer only a finite set of products and asset allocations. The statements made in the Adviser Interpretive Release could engender a regulatory environment where robo-advisers offer only level cost products out of concern that – due to technological limitations – cost and remuneration cannot be effectively incorporated into the algorithm’s criteria.⁶¹ We do not believe that to be the Commission’s intention.

⁵³ *Robo-Advisers*, IM Guidance Update No. 2017-02 (hereinafter referred to as the “2017 IM Guidance”).

⁵⁴ Adviser Interpretive Release at 21206.

⁵⁵ *Id.* at footnote 23.

⁵⁶ *See, e.g., id.* at 21206 (stating that an investment adviser must have a “reasonable believe” that personalized investment advice is suitable and in the client’s best interest).

⁵⁷ *Id.*

⁵⁸ 2017 IM Guidance at 1.

⁵⁹ *Id.* at 6-7.

⁶⁰ Adviser Interpretive Proposal at 21207.

⁶¹ We note, for example, that costs will vary greatly depending on the mix of investments generated by the robo-adviser’s algorithm. It may not be feasible as a practical matter for an algorithm to evaluate the costs of every possible scenario to ensure that a particular asset allocation is the least expensive of all equal alternatives. In addition, technological limitations may prevent robo-advisers from ensuring information is accurate and complete at all times since much of this data would be provided by third-parties over which the robo-adviser has no control. Though such a task is inconsequential for a human being, it would be a highly complex endeavor for a computer program.

* * * * *

We appreciate the opportunity to comment on the proposal. If you have any questions regarding our comments or would like additional information, please contact me at [REDACTED] or [REDACTED].

Sincerely,

/s/ Robin C. Swope

Robin C. Swope
Director, Global Product Governance
& Support

cc: The Honorable Jay Clayton
The Honorable Kara M. Stein
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce

Dalia O. Blass, Director
Division of Investment Management

Brett Redfearn, Director
Division of Trading and Markets