

JACKSON, GRANT

INVESTMENT ADVISERS, INC.

Brent Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

August 7, 2018

Re: 1) SEC Rel. No. 34-83062; File No. S7-07-18 Regulation Best Interest (“**BI Proposal**”) at <https://www.sec.gov/rules/proposed/2018/34-83062.pdf>
2) SEC Rel. No. 34-83063; File No. S7-08-18 Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles (“**CRS Proposal**”) at <https://www.sec.gov/rules/proposed/2018/34-83063.pdf>

Secretary Fields,

The CRS¹ and BI² Proposals will touch the lives of millions of everyday Americans, from those in their 20’s who are embarking on careers (and decades of saving and investing), to retirees who need to create income for a lifetime.³

These individuals need to understand how the financial services marketplace functions and how to make it work for them.

Proposals BI and CRS are a step in the right direction, but they are not sufficiently developed to avoid a “mismatch between the type of advice that is received and the type of advice that is preferred.” Misunderstandings about the roles and services a firm or financial professional provides will persist for a number of reasons that will not be solved with the new proposed best interest standard or CRS disclosures.

First, the Best Interest standard will need to be tested in operation over a number of years and in a number of different circumstances. Even the definition of “recommendation” will need to be

¹ The stated goal of the 471-page CRS Proposal is to propose new rules to “inform” investors “about the relationships and services [firms offer] and to “reduce investor confusion in the marketplace for [broker-dealer and investment adviser] services.” While I will not comment on each question posed (we counted 742 in the CSR Proposal and 384 in the BI Proposal), I will share my views on what I see as the most impactful.

² The stated goal of the 408-page BI Proposal is to propose a new rule to establish a “standard of conduct for broker-dealers and [their associated persons] “when making a recommendation of any securities transaction or investment strategy investing securities to a retail customer. The proposed standard of conduct is to act in the best interest of the retail customer at the time a recommendation is made without placing the financial or other interest of the broker-dealer or ... [associated person] ... making the recommendation ahead of the interest of the retail customer.”

³ The Department of Labor’s “Fiduciary Rule” which affected IRAs (prohibited transactions) and ERISA retirement accounts, was vacated on March 15, 2018 by the US Court of Appeals for the Fifth Circuit.

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developed.⁴ The rule set will evolve over time through practical application, supervisory and compliance reviews --- and through customer arbitrations. BD customer arbitrations will increase and BDs will see “enhanced legal exposure,” according to the SEC, as a result of the Care Obligation that is incorporated into the newly proposed Best Interest standard.⁵

Only time will tell whether the proposed standard will evolve into a practical way for customers of BDs to know and understand what to expect from a BD, whether the BD is stand-alone or dually registered and a dually-hatted representative is acting as a broker.

Second, as is shown by survey data cited in the proposals, customers of BDs believe their financial representative currently puts the client’s interest ahead of his or her own when making a recommendation.

That standard (fiduciary⁶) applies when an individual retains an RIA (or an individual who is dually hatted (BD/RIA) but only when he is acting in his RIA capacity (or in rare cases, with discretion under a written agreement with the customer).

Because individuals are not aware of these differences, confusion will persist.

To help mitigate confusion, the SEC could require stand-alone BDs, and the dually registered (when acting as BDs) to provide the type of disclosure that is required of RIAs, namely the ADV Part 2A. That document sets out in a specially required format how services are delivered and where conflicts exist in a relationship.

How firms pay their representatives would need to be an additional disclosure item, since many consumers believe that pay is not dependent on recommendations made to them. As is shown in the example in the footnote, the description is lengthy, reflecting the many different ways the

⁴ “The term ‘recommendation’ has been interpreted in the context of Commission rules, the FINRA suitability requirement, and the DOL Fiduciary Rule,” however, it has not been defined or described fully in this context of the BI Proposal. [BI Proposal p. 91.]

⁵ “The requirements of the Care Obligation of proposed Regulation Best Interest mirror closely but are not identical to the current broker-dealer practices pursuant to the requirements of FINRA’s suitability rule and other applicable legal standards. The first important difference is the requirement that broker-dealers have a reasonable basis to believe that a recommendation is in the best interest of a retail customer and that a series of recommendations is not excessive and in the best interest of the retail customer. The suitability standard does not have an explicit best interest requirement and therefore broker-dealers may be able to make recommendations today that, while suitable, may not meet the Care Obligation proposed as part of Regulation Best Interest. As noted above, to the extent that current broker-dealer practices pursuant to the requirements of FINRA’s suitability rule do not reflect the proposed best interest standard of conduct, the Care Obligation would impose a cost on broker-dealers. The other important difference is the removal of the element of control from the requirement to have a reasonable basis to believe that a series of recommendations is not excessive and in the best interest of the retail customer. As noted above, unlike the quantitative suitability requirement of FINRA’s suitability rule, this requirement of the Care Obligation applies irrespective of whether a broker-dealer has actual or de facto control over the account of the retail customer. To the extent that the removal of the element of control may cause a potential increase in retail customer arbitrations, the Care Obligation would impose a cost on broker-dealers due to enhanced legal exposure.” [BI Proposal Note 485 p. 287-288]

⁶ Despite the SEC’s assertion that BI is “not intended to impact the fiduciary obligations under the Advisers Act,” the introduction of this new standard will impact the legal obligations of RIAs in this one very important aspect: it adds to investor confusion.

financial representative is remunerated.⁷ Do customers understand this very important information? Probably not. Notably, it is not something that can be easily made part of a 4-page CRS. However, compensation is of utmost importance for any investor to be able to assess the motivation of the representative in making a recommendation.

⁷ The following is quoted from a dually registered firm's description of services in a section entitled: "How our Financial Advisors are compensated"

"In general, we pay a percentage of clients' commissions and fees, called a payout rate, to our Financial Advisors, according to an established schedule based on the revenues the Financial Advisor generates with his or her entire client base.

- For transaction-based accounts, which hold products such as stocks, bonds, options and mutual funds, the payout rate ranges from 24% to 44% of the commissions or sales charges paid to the Firm. For stock and option transactions, the payout is reduced by \$12 per transaction.
- For insurance and annuity products, the payout ranges from 24% to 49% of the commissions or sales charges paid to the Firm.
- For our asset-based fee programs, the payout generally ranges from 24% to 47% of the fees earned by the Firm.

In general, Financial Advisors earn more for products sold in initial offerings than for those purchased and sold in secondary offerings.

The percentage of Firm revenues that Financial Advisors receive in asset-based programs and insurance products is higher than the percentage of Firm revenues they receive on most other products and services.

Additional Compensation Financial Advisors May Receive

A Financial Advisor may also be eligible for bonuses based on:

- His or her annual total revenues and/or length of service with our Firm
- The total asset level of the Financial Advisor's client base, including credit line balances
- New assets and credit lines from both current and new client

Vendors, such as mutual fund wholesalers, annuity wholesalers, unit investment trust wholesalers, investment managers and insurance distributors, may pay certain expenses on behalf of Financial Advisors, including expenses related to training and educational efforts. (Similarly, in some instances, vendors may make payments to our Firm to subsidize training costs for Financial Advisors.) Such vendors may also give Financial Advisors gifts, up to a total value of \$100 per vendor per year, consistent with industry regulation. In addition, vendors may occasionally provide Financial Advisors with meals and entertainment of reasonable and customary value.

In addition, investment managers and/or affiliates may arrange for commissions to be paid to Financial Advisors or affiliates (called "directed commissions") for trading activities here or at other broker-dealers, including our affiliates. Financial Advisors may also receive referral fees or finder's fees for referring business to affiliates or assisting others in developing new business.

Compensation for New Financial Advisors

In the first four years of a career as a Financial Advisor, compensation is based on a combination of salary, payout on the Financial Advisor's total annual revenues and client assets, plus a bonus based on new assets. In the first two years, a Financial Advisor may also receive additional compensation on the amount of assets in certain asset-based fee accounts.

Your Relationship With Your Financial Advisor

At the heart of our wealth management process is the relationship you have with your Financial Advisor. By asking the right questions, regularly assessing your needs, and always listening, your Financial Advisor can help you manage your finances in the way that suits your individual circumstances, goals and tolerance for risk."

Compensation for RIAs is also detailed, as seen from the instructions to item 5 of ADV Part 2A.⁸ Other activity⁹ and client referrals and other compensation¹⁰ also need to be addressed for the investor to fully understand the potential for conflicts of interest in any relationship. They include, as is stated in the BI Proposal:

1. Recommending proprietary products and products of affiliates;
2. Engaging in principal trades with respect to a recommended security (e.g., fixed income products);
3. Recommending a limited range of products and/or services;

⁸ ADV Part 2A Instructions for “Item 5 Fees and Compensation A. Describe how you are compensated for your advisory services. Provide your fee schedule. Disclose whether the fees are negotiable. Note: If you are an SEC-registered adviser, you do not need to include this information in a brochure that is delivered only to qualified purchasers as defined in section 2(a)(51)(A) of the Investment Company Act of 1940. B. Describe whether you deduct fees from clients’ assets or bill clients for fees incurred. If clients may select either method, disclose this fact. Explain how often you bill clients or deduct your fees. C. Describe any other types of fees or expenses clients may pay in connection with your advisory services, such as custodian fees or mutual fund expenses. Disclose that clients will incur brokerage and other transaction costs, and direct clients to the section(s) of your brochure that discuss brokerage. D. If your clients either may or must pay your fees in advance, disclose this fact. Explain how a client may obtain a refund of a pre-paid fee if the advisory contract is terminated before the end of the billing period. Explain how you will determine the amount of the refund. E. If you or any of your supervised persons accepts compensation for the sale of securities or other investment products, including asset-based sales charges or service fees from the sale of mutual funds, disclose this fact and respond to Items 5.E.1, 5.E.2, 5.E.3 and 5.E.4. 1. Explain that this practice presents a conflict of interest and gives you or your supervised persons an incentive to recommend investment products based on the compensation received, rather than on a client’s needs. Describe generally how you address conflicts that arise, including your procedures for disclosing the conflicts to clients. If you primarily recommend mutual funds, disclose whether you will recommend “no-load” funds. 2. Explain that clients have the option to purchase investment products that you recommend through other brokers or agents that are not affiliated with you. 3. If more than 50% of your revenue from advisory clients results from commissions and other compensation for the sale of investment products you recommend to your clients, including asset based distribution fees from the sale of mutual funds, disclose that commissions provide your primary or, if applicable, your exclusive compensation. 4. If you charge advisory fees in addition to commissions or markups, disclose whether you reduce your advisory fees to offset the commissions or markups. Note: If you receive compensation in connection with the purchase or sale of securities, you should carefully consider the applicability of the broker-dealer registration requirements of the Securities Exchange Act of 1934 and any applicable state securities statutes.”

⁹ Instructions to Form ADV Part 2A “Item 10 Other Financial Industry Activities and Affiliations A. If you or any of your management persons are registered, or have an application pending to register, as a broker-dealer or a registered representative of a broker-dealer, disclose this fact. B. If you or any of your management persons are registered, or have an application pending to register, as a futures commission merchant, commodity pool operator, a commodity trading advisor, or an associated person of the foregoing entities, disclose this fact. C. Describe any relationship or arrangement that is material to your advisory business or to your clients that you or any of your management persons have with any related person listed below. Identify the related person and if the relationship or arrangement creates a material conflict of interest with clients, describe the nature of the conflict and how you address it. 1. broker-dealer, municipal securities dealer, or government securities dealer or broker 2. investment company or other pooled investment vehicle (including a mutual fund, closed-end investment company, unit investment trust, private investment company or “hedge fund,” and offshore fund) 3. other investment adviser or financial planner 4. futures commission merchant, commodity pool operator, or commodity trading advisor 5. banking or thrift institution 6. accountant or accounting firm 7. lawyer or law firm 8. insurance company or agency 9. pension consultant 10. real estate broker or dealer 11. sponsor or syndicator of limited partnerships. D. If you recommend or select other investment advisers for your clients and you receive compensation directly or indirectly from those advisers that creates a material conflict of interest, or if you have other business relationships with those advisers that create a material conflict of interest, describe these practices and discuss the material conflicts of interest these practices create and how you address them.”

¹⁰Instructions to ADV Part 2A “Item 14 Client Referrals and Other Compensation A. If someone who is not a client provides an economic benefit to you for providing investment advice or other advisory services to your clients, generally describe the arrangement, explain the conflicts of interest, and describe how you address the conflicts of interest. For purposes of this Item, economic benefits include any sales awards or other prizes. B. If you or a related person directly or indirectly compensates any person who is not your supervised person for client referrals, describe the arrangement and the compensation. Note: If you compensate any person for client referrals, you should consider whether SEC rule 206(4)-3 or similar state rules regarding solicitation arrangements and/or state rules requiring registration of investment adviser representatives apply.”

4. Recommending a security underwritten by the firm or a broker-dealer affiliate, including initial public offerings;
5. Allocating investment opportunities among retail customers (e.g., IPO allocation);
6. Receiving third-party compensation in connection with securities transactions or distributions (e.g., sales loads, ongoing asset-based fees, or revenue sharing); and
7. Providing ongoing, episodic or one-time advice.

The proposals cite the “confusion” that results and the potential for “mismatches” that occur as a result.

The goal of the CRS is to help people discern the differences between financial firms and financial professionals, enough so that customers can match themselves with the service providers that are right for them.

The CRS in the form proposed will not eliminate, nor even lessen, that confusion. Based on my experience communicating with members of the public of all financial means through my column and books,¹¹ and in my role at my firm¹² where I serve a more narrow demographic band of high net worth families, I do not believe the CRS will, as the proposal suggests, lead to investors sharing “it with family and friends.”¹³ The subject matter will not trigger compelling or intriguing social engagement.

Nonetheless, there is no question that the public is unaware that different legal standards apply to RIAs (fiduciary¹⁴) vs BDs and their associated persons (suitability¹⁵).¹⁶ That conclusion is supported by survey data and focus reports referenced by the SEC in the proposals – and I can attest to it through my personal interaction with readers of my weekly investor education column, attendees at my lectures, and in my professional experience.

I might add that confusion is greater today than it was before brokerage firms began offering managed accounts. Before then, a broker acted as a “customer’s man” representing the customer

¹¹ Syndicated by King Features; recognized for clarity (sample award: Clarion Award (2018) “symbolizing excellence in clear, concise communications.”) <http://kingfeatures.com/features/columns-a-z/retirement-planning-and-investment/>

¹² In contrast to more complex dually registered firms, there are RIA firms like Jackson, Grant Investment Advisers, Inc. that offer what I would call a pure fiduciary experience, with no propriety products, no incentive payments for referrals, no commissioned salespeople, no sales contests, no sales quotas -- nothing that interferes with the offering of investment supervisory services to a select high net worth clientele that want to be removed from the culture of the Street. In essence, these firms serve in a “fiduciary only-and-always” role -- my term.

¹³ CRS Proposal pp. 268, 295 and 348.

¹⁴ The term fiduciary is referred to 225 times in BI Proposal and 88 times in the CRS Proposal.

¹⁵ The term suitability is referred to 158 times in the BI Proposal and 6 times in the CRS Proposal.

¹⁶ “Similarly, the RAND Study generally concluded that investors did not understand the differences between broker-dealers and investment advisers and that common job titles contributed to investor confusion. Further, participants responded similarly that investment advisers and brokers are required to act in the client’s best interest. Similar to the Siegel and Gale Study, focus group participants did not understand the term fiduciary, or how the fiduciary standard differed from suitability. In addition, the RAND Study noted that the confusion about titles, services, legal obligations, and compensation persisted even after a fact sheet on broker-dealers and investment advisers was provided to participants.” [CRS p. 239-240]

to execute trades and, until May 1, 1975, brokerage commissions were fixed. There was no need for brokers to present as “advisers” or “advisors.”

Before the 2007 Financial Planning Association v. SEC case, managed accounts were sold through the brokerage system as “solely incidental” to the brokerage business. At the time, marketing material had to clearly disclose that even though the service looked like it might be the work of an adviser, it was not:

“Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits, and our sales person’s compensation, may vary by product and over time.”¹⁷

After the 2007 D.C. Circuit court case ruled in favor of the Financial Planning Association, more brokerage firms became dually registered (both RIAs and BDs) in order to continue selling managed accounts. The clear disclosure quoted above was replaced with RIA disclosure (ADV Part 2A), which is not as effective. For example:¹⁸

“As our client, you work with your dedicated personal financial advisor and team (your “Advisor”) to determine if the Program is appropriate for you given your financial goals and circumstances. Based on the services you request, we can help fulfill your wealth management needs in our capacity as an investment adviser, as a broker-dealer, or as both. Most of our Advisors are qualified and licensed to provide both brokerage as well as investment advisory services. Investment advisory and brokerage services are separate and distinct and each is governed by different laws and separate arrangements that we may have with you. Our relationship and legal duties to you under federal securities laws are subject to a number of important differences.”

Different standards are hinted at. How the salesperson is compensated is not addressed. It should not be a mystery.

Quoting from the CRS Proposal: “many retail customers generally *and reasonably expect* [emphasis added] that their investment firms and professionals, *including broker-dealers*, [emphasis added] will – and rely on them to – provide advice that is in their best interest by placing investors’ interest before their own.”

While those expectations will be met through stand-alone RIAs, they will only be met through stand-alone BDs and dually registered BD/RIA if there is full disclosure of the type that

¹⁷ Footnote 4 of Financial Planning Association, Petitioner vs. SEC, Respondent (DC Cir. 2007), quoting the disclosure required when selling a managed account. The court struck down the regulation that permitted offering a managed account a solely incidental to the conduct of a broker-dealer.

¹⁸ For an example, see the Merrill Lynch Investment Advisory Program Wrap Fee Program Brochure at https://olui2.fs.ml.com/publish/ESIGN_EXPAN/TandC/MSGDisclosure.pdf

addresses conflicts of interest openly and clearly. The CRS as proposed does not go far enough in describing how the salesperson can benefit from making various recommendations. It would help if we all recognized that in today's world, most investors will likely deal with the dually-hatted professional¹⁹ and that relationship is the most complicated and potentially least understood.

The CRS should be a single document for all BDs, RIAs, and dually registered. The most important message should be the role of the representative and how conflicts can arise. Language and format should be prescribed by the SEC.

Part 1 should describe the state of legal responsibility for three categories of firms:

All stand-alone Brokers need to be called Stand-Alone Brokers.

All stand-alone RIAs need to be called Stand-Alone RIAs.

All dually registered firms need to be called Dually Registered Firms.

All representatives need to be called "representatives," not advisers or advisors, particularly those who work for dually registered firms. They should be called "Dually Hatted Representatives."

It should be made clear that the representative will be acting in a certain legal capacity, as defined by the SEC. When describing fiduciaries, it needs to be made clear that the fiduciary duty is higher than "best interest."

It should be made clear that dually hatted representatives can change hats and that it is the duty of the customer to query the representative each and every time he makes a recommendation – which hat are you wearing at the moment? The answer needs to be preserved in writing.

Next should be a description of compensation and incentives the representative can receive as a result of making recommendations or providing services. This is where potential conflicts need to be enumerated. In my view, representative compensation and incentives invites conflicted actions – that is the center of the equation.

What fees are payable are next, but keep in mind that they are not as important as compensation to the representative. For example, representatives may reasonably answer the question of how much a customer would pay for a mutual fund C share as "zero commission." However, if you

¹⁹ Notably, about 88 percent of investment adviser representatives are dually hatted as registered representatives. [CRS Proposal p. 226] About 50 percent of registered representatives are dually registered as investment adviser representatives. [CRS Proposal p. 227]

"As of December 2017, there were approximately 3,841 registered broker-dealers with over 130 million customer accounts." (CRS Proposal p. 203) "As of December 2017, there are approximately 12,700 investment advisers registered with the Commission." (CRS Proposal p. 210) "Of all SEC-registered investment advisers, 366 identified themselves as dually registered broker-dealers. Further, 2,478 investment advisers (20%) reported an affiliate that is a broker-dealer, including 1,916 investment advisers (15%) that reported an SEC-registered broker-dealer affiliate." (CRS Proposal p. 211)

ask how much you, Mr. Representative, will get paid if I buy a C share vs. an A share, the answer will disclose more about incentives to sell one share class over another, including compensation at the time of purchase as well as ongoing compensation. Then, there needs to be a discussion of the cost to buy the shares, the ongoing cost of ownership (total operating expenses), and the cost to redeem shares (deferred sales charges).

Disclosure should also be made about brokers' books being purchased by other firms or other representatives and other potential conflicts that are not reflected in a transaction. A lot is involved and clarity will be hard to come by. But, no one can deny that it's worth a try.

Finally, I'd like to see the SEC present a follow up proposal for further comment. The issues presented are too weighty and important to set the course of conduct for BDs and RIAs at this stage. More work needs to be done.

Very truly yours,

Julie Jason

Julie Jason, JD, LL.M

Founder & Chief Investment Officer, Jackson, Grant Investment Advisers, Inc.
Proponent of Financial Literacy Education as a financial columnist, author, lecturer
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