August 7, 2018

Via: *Rule-comments@sec.gov*

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: RIN 3235-AM36
File Number S7-09-18
Request for Comment on Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers

Dear Chairman Clayton:

On behalf of our 38 million members and other Americans saving for retirement, AARP[1] appreciates the opportunity to respond to the Securities and Exchange Commission's (Commission) request for public comments on its proposed interpretation of standards of conduct for investment advisers (IA).[2] AARP believes that ensuring financial professionals, who provide retail clients with advice, are held to a fiduciary standard is in the best interest of investors saving for retirement. The fiduciary standard should be based on the core principle that when providing personalized investment advice to retail customers, IAs must always act in the best interests of those customers.

As you move forward, AARP urges the Commission to maintain its mission of protecting retail investors. The investment advisory industry is made up of diverse firms, including independent advisers, financial planners, traditional asset management firms, wealth managers, large financial institutions, small advisers, private fund managers, mutual

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[1] AARP, with its nearly 38 million members in all 50 States, the District of Columbia, and the U.S. territories, is a nonpartisan, nonprofit, nationwide organization that helps empower people to choose how they live as they age, strengthens communities, and fights for the issues that matter most to families, such as healthcare, employment and income security, retirement planning, affordable utilities and protection from financial abuse.
[2] Interpretation Regarding Standard of Conduct for Investment Advisers, 83 FR 21203 (proposed May 9, 2018) (to be codified at 17 CFR Part 275). https://www.sec.gov/rules/proposed/2018/ia-4889.pdf.

fund advisers, and others. Under the Investment Advisers Act of 1940 (Advisers Act),[3] each of these types of investment advisory firms and IA representatives are subject to regulation by the SEC and other regulators. However, there still remains a disconcerting amount of duplicity and wrongdoing by a subset of advisers as demonstrated by enforcement actions against IAs that breached their fiduciary duties and failed to act in their clients' best interest.[4] These breaches often involve a range of activities that harm retail investors, many of whom do not have expertise in financial investments.[5]

According to the Commission, an IA is a fiduciary and owes a duty of care and loyalty to the client. The duty of care, includes three components: (i) providing advice that at all times serve the best interest of its client; (ii) seeking best execution when executing trades on behalf of the client; and (iii) the duty to provide advice and monitoring of the client's accounts. The monitoring extends to all investment advice the IA provides to the client. In order to meet the care obligation, the IA must provide advice in the client's best interest, which requires that the IA understand and evaluate the client's financial situation. For example, the IA should seek to understand the client's current income, debts, assets, level of investment experience, and investment objectives. A competent financial professional working with a client would need to gather the requisite information and undertake this exercise in order to provide advice in the client's best interest.

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[3] 15 U.S.C. § 80b-1 through 15 U.S.C. § 80b-21, Investment Advisers Act of 1940, http://legcounsel.house.gov/Comps/Investment%20Advisers%20Act%20Of%201940.pdf.

[4] *See* In the Matter of Total Wealth Management Inc., Jacob Keith Cooper, Nathan Mcnamee and Douglas David Shoemaker, https://www.sec.gov/litigation/admin/2015/33-9989.pdf. Total Wealth failed to disclose conflicts and sought to hide fees. Total Wealth also misrepresented the extent of the due diligence conducted on the investments they recommended to clients. *See also* In the Matter of Laurence I. Balter d/b/a Oracle Investment Research, https://www.sec.gov/litigation/admin/2017/33-10367.pdf. Balter, an IA to the Oracle fund, where he had 120 separately managed accounts, engaged in multiple breaches of fiduciary duty by fraudulently allocating profitable trades to his own accounts at the detriment of his clients. The majority of Balter's advisory clients were individual investors, many of whom were over the age of 60, retired or nearing retirement, and with little investment experience.

[5] *See* In the Matter of Tenemos Advisory, Inc. and George L. Taylor, https://www.sec.gov/litigation/complaints/2018/comp-pr2018-137.pdf. The complaint alleges Temenos and Taylor steered clients, including seniors and retirees, into risky private offerings; concealed high commissions from unsuitable investment recommendations; misled clients about the risks and prospects of the investments; and grossly overbilled.

The concepts setting forth the duties of a fiduciary under the Advisers Act are well settled in law and SEC guidance.[6] However, we believe that some improvements can be made to protect retail investors when selecting and receiving advice from IAs.

I. The Commission should codify the fiduciary standard.

Currently, an IA's fiduciary duty is implied in the Adviser's Act and its application is based on a strong record of case law and SEC guidance. Section 206 of the Advisers Act prohibits misstatements or misleading omissions of material facts and other fraudulent acts and practices in connection with the conduct of an investment advisory business. As a fiduciary, an IA owes its clients undivided loyalty and cannot engage in activities that conflict with a client's interest without consent. In *S.E.C. v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), the seminal case interpreting the Advisers Act, the Supreme Court held that IAs have an affirmative obligation of utmost good faith and full and fair disclosure of all material facts to their clients, as well as a duty to avoid misleading them. However, the Commission has recognized there are certain IAs who have interpreted the fiduciary duty to be less than what is clearly required under law and set forth in case law and precedent.

Therefore, the Commission should explicitly codify the fiduciary duty and its interpretations. Codifying an explicit fiduciary duty would reinforce IA's obligations to their retail clients, which in turn would result in increased compliance with the important duties IAs owe to their clients. The benefit of this approach for retail customers would be better quality and less conflicted advice, more focus on the obligations advisers owe to clients, more effective monitoring, and more transparent disclosures of conflicts of interest, which we believe would facilitate better informed decision-making on the part of retail investors.

II. Uniform application of the fiduciary standard is in the best interest of consumers.

The Commission should adopt a uniform fiduciary standard for financial professionals that applies to all types of retail accounts. There is no question that there is confusion among retail investors in the marketplace as a result of standards that are not uniform

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[6] *See S.E.C. v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 184-85 (1963). The U.S. Supreme Court held that under §206, IAs have an affirmative obligation of utmost good faith and full and fair disclosure of all material facts to their clients, as well as a duty to avoid misleading them.
See also In the Matter of Arleen W. Hughes, d/b/a E.W. Hughes & Company, Exchange Act Release No. 4048, (Feb. 18, 1948), https://www.sec.gov/litigation/opinions/ia-4048.pdf.

and do not address the perpetually evolving universe of investment products and industry practices.[7] The term "best interest" further garners confusion and must be clearly defined. "Best interest" is referenced by FINRA in the context of suitability,[8] by the Adviser's Act in the context of the duty of care, and until recently by the Department of Labor in the context of fiduciary duties.[9] In order to protect retail customers from further confusion, more guidance on what "best interest" means is required. In accordance with the clear duties the fiduciary standard requires, the adoption of a uniform standard, that would apply to both IAs and BDs when providing personalized investment advice to retail customers, as contemplated by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Section 913), is of critical importance and long overdue. The standard should be based on the core principle that when providing personalized investment advice to retail customers, a financial professional must always act in the best interests of those customers regardless of their marketing strategy, business model, or registration status. It is crucial that all financial professionals who offer investment advice to retail investors are subject to a fiduciary standard to ensure a level and transparent market for consumers seeking investment advice.

Furthermore, there is no evidence that strengthening the standards of care, with the goal of better protecting retail investors, will result in fewer products for retail investors. Americans saving for retirement have the majority of their savings in defined contribution plans and IRAs. Given the nearly $8 trillion in assets in IRAs and the almost $5 trillion in 401(k) plans, there is neither evidence, nor any reason to believe, that financial service providers will abandon this lucrative market. To the extent there are disruptions in the marketplace, retail investors stand to benefit as the financial services industry adjusts their strategies and product offerings in order to maintain their competitive edge while meeting a heightened standard of care. AARP has every confidence that the financial services industry will continue to thrive and develop innovative new products and systems to help hard-working Americans save for retirement.

III. The Commission should clarify disclosure rules.

[7] Angela Hung et al., *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*, RAND Corp. (2008).
[8] *See* http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq; *See also* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=9859
[9] https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2

Disclosure alone does not provide adequate consumer protections. However, disclosures may be helpful when designed to be clear and informative, as well as, coupled with robust rules governing standards of conduct for financial advisers. The information provided in a disclosure must understandable so that retail investors can make an informed decision.

Indeed, tens of thousands of complaints are filed each year because IAs did not disclose or explain fees, potential discounts or penalties, and/or additional charges for investment changes, such as mutual fund switches. Therefore, the Commission should require IAs to provide appropriate fee disclosure any time they make a recommendation to a retail customer. We recommend that the Commission not take a narrow approach to disclosures by the type of account, particularly where "retail" accounts are concerned. Individuals may have different types of accounts and IAs often recommend multiple types of products to retail investors. A retail investor cannot make an informed decision if they do not know the risks, rewards, conflicts, and fees in advance of their decision. To the extent that current SEC rules permit disclosure at the time of the sale of an investment, all such rules should be promptly amended to ensure all key disclosures are made in advance of an investment decision.

Disclosure at the time of or immediately prior to engagement is not adequate. Advisers should not be permitted to hand a packet covering fees and other disclosures to a retail customer as the transaction is being signed or finalized. The Commission should make it clear that this is inadequate and require a more appropriate amount of time for the retail investor to understand and seek clarification before committing.

a. Disclosure of dual status.

Today, many clients have a brokerage account as well as an advisory account. The regime that the Commission is proposing with the proposed Regulation Best Interest would further cement this dichotomy of standards, which has not benefitted retail customers as evidenced by the constant need for regulatory enforcement.[10] It is imperative that all financial professionals explicitly, verbally and in writing, articulate to retail customers what their status is and under what circumstances they are allowed to switch hats. BDs typically have form ADV 2b brochure supplements when they are also doing advisory business as well as brokerage business in which they act as sales people. However, they are only subject to specific "investment adviser" rules and requirements for the accounts in advisory programs. Retail investors with both advisory and brokerage accounts should be informed of any changes in the standard of care

[10] *See* Final Rule: Amendments to Form ADV, https://www.sec.gov/rules/final/2010/ia-3060.pdf. *See also* the SEC Investor Bulletin on the Form ADV-Investment Adviser Brochure and Brochure Supplement, https://www.sec.gov/oiea/investor-alerts-bulletins/ib_formadv.html.

upfront in the relationship as well as in advance of a change in the standard of care involving the client.

b. Disclose fiduciary status.

Additionally, IAs must be required to tell potential and engaged retail investors if they are acting as a fiduciary and that acting as a fiduciary means they are acting solely in the consumer's best interest. The IA should acknowledge in writing that he is a fiduciary and must agree to adhere to the best interest standard of care. This acknowledgement should be disclosed and delivered in writing to the retail consumer. The IA must also disclose any material conflicts of interest.

c. Documentation and proper disclosure.

IAs must be required to ask retail consumers about their investing needs and seek to understand the investor's goals and personal circumstances. IAs should be required to document the types of investments the investor wants, what the adviser recommends, what the investor agreed to, in addition to all key terms and conditions. A paper copy should be provided to the retail investor once this discussion has concluded for record keeping.

Additionally, documents and disclosures should always be provided in paper form, days in advance, of any transaction. IAs may ask to provide documents electronically, but in all circumstances a summary of key documents and disclosures should be provided to retail investors in paper form and the IA should obtain a signature confirming receipt before any final contract adoption. The Commission should prohibit IAs from solely providing an electronic address for retail investors to pull disclosures for review. They should not be permitted to automatically require investors to search online for critical consumer disclosures.

Furthermore, oral disclosures should never be permitted unless substantiated by the delivery of a paper disclosure. Advisers should always be required to provide disclosures in advance and on paper. The Commission must consider the implications of electronic versus paper disclosures. A prospectus or summary of additional information can be over 100 pages long and are difficult for retail investors to read and understand. Key information, fees, and conditions should be accessible and highlighted to ensure retail investors see the information and waivers should be short and clear so investors actually read them.

Fee, conflict of interest, surrender and change of contract charge disclosures should be provided substantially before the completion of the sale and execution of a transaction.

If BDs are making investment recommendations, then they should be held to the same investment recommendation standards as other IAs.

d. Compensation arrangements.

As to compensation, the IAs should always disclose fees (commissions/compensation); ensure that fees/compensation are reasonable;[11] and be prohibited from receiving additional financial incentives such as trips, awards, or bonuses.

Furthermore, the issue of fair compensation merits additional discussion and analysis. We believe it is critical that the Commission also consider alternative sales incentives that may be classified as nonfinancial in nature. For example, is a promotion or title bump financial or nonfinancial? Such indirect/nonfinancial benefits to IAs raise red flags and are worth further consideration as we seek to ensure adequate investor protections are established in the Commission's rulemaking.

IV. Conclusion

AARP remains committed to the strongest possible fiduciary standard for retail investment advice and recommends a uniform standard of care for all investment professionals. There is a growing need to provide retail investors with additional protections so that they can save and invest in preparation for a secure retirement. AARP opposes any attempt to weaken the existing fiduciary standard for IAs, which would have negative consequences for retail investors.

We look forward to working with you and your colleagues to ensure that the Commission's rulemaking, and its companion proposals 3235-AM35 and 3235-AL27, deliver meaningful investor protections for the customers of investment advisers and broker-dealers. If you have any questions, please feel free to contact me or Jasmine Vasquez, of our Government Affairs office, at [redacted] or at [redacted].

Sincerely,

David Certner
Legislative Counsel and Legislative Policy Director

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[11] Whether a plan's fees are reasonable depends on the facts and circumstances relevant to an investor's particular situation (including but not limited to benchmarking, meaningful comparisons for the product, the consumer's risk tolerance, and the consumer's liquidity needs). The IA should obtain and consider all relevant information and then make a determination supported by that information.