Allianz Global Investors

August 7, 2018

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

Re: **Notice of Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers**

Dear Mr. Fields,

Allianz Global Investors U.S. LLC (together with its affiliates, "**AllianzGI**") respectfully responds to the Securities and Exchange Commission's (the "**Commission**") invitation to provide comments on its proposed package of rulemakings and interpretation relating to the standards of conduct for investment advisers and broker-dealers, questions regarding the standards of conduct applicable to investment advisers and broker-dealers, and related matters.[1] AllianzGI is one of the world's leading active investment managers, managing over $631 billion in assets for individuals, families and institutions globally.[2] We invest for the long term across a range of different investment strategies, covering different investment styles and asset classes. Our clients come to AllianzGI to save and invest money for education and retirement; grow endowments to support research and education for future generations; manage retirement plans for public employees; invest in projects to improve infrastructure and pursue a multitude of other long-term financial goals.

[1] *Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles*, SEC Rel. IA-4888 (Apr. 18, 2018) ("Proposing Release"); *Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers* ("Proposed Interpretation")*; Request for Comment on Enhancing Investment Adviser Regulation*, SEC Rel. IA-4889 (Apr. 18, 2018); *Regulation Best Interest*, SEC Rel. 34-83062 (Apr. 18, 2018).
[2] As of March 31, 2018, AllianzGI manages over $631 billion USD for institutional and retail investors worldwide.

Underlying each of the diverse set of client mandates for which we are responsible is our fiduciary duty and commitment to actively manage risk in our clients' portfolios, always seeking to achieve an optimum balance between risk and return. In furtherance of that goal, we continually seek to evolve existing and develop new products and solutions that will meet our clients' needs. AllianzGI distributes its investment products and solutions directly to institutions and indirectly to the public through several different investment advisers, broker-dealers and other financial service firms, and therefore we have a significant interest in the Commission's package of proposed new rules and interpretation.

We appreciate the Commission's commitment to engagement and applaud its efforts to provide clear, understandable and consistent standards and preserve investor choice and access to existing products, services, service providers and payment options.[3]

The package of proposals is designed to: (1) clarify and strengthen the standard of conduct for broker-dealers, requiring that broker-dealers act in the best interest of retail customers when making recommendations (Regulation Best Interest); (2) reaffirm and clarify certain aspects of the fiduciary duty that an investment adviser owes to clients under section 206 of the Investment Advisers Act of 1940 ("Advisers Act"); and (3) reduce investor confusion through new disclosures required under Regulation Best Interest and in Form CRS and by restricting the use of certain titles by broker-dealers. Taken as a whole, the proposals are intended to increase investor protection and the quality of investment services by enhancing investor understanding and increasing required standards of conduct, while simultaneously preserving investor choice, through a comprehensive package of rules and guidance.[4]

Our comments are focused on the proposed interpretation regarding an investment adviser's fiduciary duty under section 206 of the Advisers Act. We note the Commission seeks comments specifically in response to the following questions:

- Does the Commission's proposed interpretation offer sufficient guidance with respect to the fiduciary duty under section 206 of the Advisers Act?
- Are there any significant issues related to an adviser's fiduciary duty that the proposed interpretation has not addressed?
- Would it be beneficial for investors, advisers or broker-dealers for the Commission to codify any portion of our proposed interpretation of the fiduciary duty under section 206 of the Advisers Act?

[3] *See* Regulation Best Interest Proposal, at section I.B.
[4] *See* Public Statement of Chairman Jay Clayton, Overview of the Standards of Conduct for Investment Professionals Rulemaking Package (Apr. 18, 2018).

Although an investment adviser's fiduciary duty is not expressly articulated in the Advisers Act, AllianzGI has always embraced its role as a fiduciary, and we are pleased with the Commission's decision to reaffirm the fiduciary duty under the Advisers Act. Nevertheless, while we appreciate the Commission's considerable efforts to pull together several decades of legislative history, staff guidance and case law to clarify and reaffirm the nature of an investment adviser's fiduciary duty, we have concerns about certain parts of the Proposed Interpretation as drafted and are recommending several revisions and clarifications. Generally, our concerns relate to ambiguities or inconsistencies in the Proposed Interpretation that we believe could ultimately have a negative impact on investors, in some cases undermining the Commission's goal of preserving investor choice. With such clarifications, we believe the Commission's Proposed Interpretation will serve investors well, and codification of the fiduciary duty in section 206 of the Advisers Act will be unnecessary and possibly counterproductive.

I. Does the Commission's proposed interpretation offer sufficient guidance and are there any significant issues related to an adviser's fiduciary duty that the proposed interpretation has not addressed?

We share the Commission's view that the fiduciary duty is "fundamental to advisers' relationships with their clients under the Advisers Act," and as such an investment adviser "must act in the best interest of its client." We also agree with the Commission that as fiduciaries investment advisers owe their clients both a duty of care and a duty of loyalty. However, because of certain ambiguities and inconsistencies in the text, we do not believe the Proposed Interpretation as drafted offers sufficient guidance with respect to an investment adviser's fiduciary duty. Accordingly, we recommend below several revisions and clarifications to the Proposed Interpretation.

A. Duty of Care

First, with respect to the duty of care, we note that the Proposed Interpretation identifies three component parts: "(i) the duty to act and to provide advice that is suitable and in the best interest of the client, (ii) the duty to seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades, and (iii) the duty to provide advice and monitoring over the course of the relationship."

In explaining how an investment adviser must meet its obligation to provide advice that is suitable and in the best interest of the client, the Proposed Interpretation states that an investment adviser "must…make a reasonable inquiry into the client's investment profile," including the "client's financial situation, level of financial sophistication, investment experience, and investment objectives." [5] The Commission explains that the nature and extent of the inquiry will "turn on what is reasonable under the circumstances,

[5] Proposed Interpretation at 9-10.

including the nature and extent of the agreed-upon advisory services, the nature and complexity of the anticipated investment advice, and the investment profile of the client."[6] However, we are concerned that the Proposed Interpretation does not distinguish between retail investors and institutional or highly sophisticated individual clients. The type of inquiry described in detail in the Proposed Interpretation may very well be reasonable for retail clients, and in fact many investment advisers already request such information from their retail clients. The Commission should clarify whether investment advisers will be expected to adopt new procedures in their onboarding processes for all clients, regardless of the client's level of sophistication. Without such clarification, we are concerned the asset management industry will experience uncertainty and confusion, with long-standing, widely adopted practices questioned.

On a related note, in our view the Commission's definition of "investment profile" generally does not fit the institutional business. Other factors (e.g., integration of ESG factors, tax management requirements, ethical constraints, long-term income generation to balance defined benefit plan or similar liabilities) tend to be the key drivers behind an institutional client's decision to invest in a particular strategy and thus form the basis of our suitability analysis. Moreover, in our experience (in dealing with KYC requirements of other jurisdictions) institutional clients are likely to resist providing some of the information in the Proposed Interpretation's formulation of "investment profile," concluding that the requests are unnecessary and burdensome.

Finally, we appreciate the Commission's observations that "cost (including fees and compensation) associated with investment advice would generally be one of many important factors" to consider when determining whether an investment strategy is in the best interests of the client and that the fiduciary duty does not necessarily require an adviser to recommend the lowest cost product or strategy. However, we caution the Commission to avoid focusing on cost, to the exclusion of or minimizing other factors.

An over-emphasis on fees disproportionately favors index investing without regard for the client's overall investment outcome. While an asset allocation to low cost index products may be appropriate for some clients, index products can be one dimensional and may not serve other investors' needs because they only provide returns correlated to the market. Actively managed products may have higher fees, but these products can also deliver outcomes that are not possible with pure beta products (i.e., index funds), offering returns that are not necessarily correlated with the markets. The best interests of investors will not be served if cost becomes a predominant driver in determining what investment options are in the best interest of a client. Investor choice and outcome-oriented investing, the preservation of which is a goal often articulated by the Commission, will both suffer. We recommend that, rather than suggest that an investment adviser "could not reasonably believe" a higher cost product "is in the best interest of a client,"[7] the Commission simply state that cost may be one of many factors to consider in determining whether certain investment advice is in the best interest of a client.

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[6] "For example, to formulate a comprehensive financial plan for a client, an adviser might obtain a range of personal and financial information about the client, including current income, investments, assets and debts, marital status, insurance policies, and financial goals." *Id.* at 10.

[7] *See* Proposed Interpretation at 12.

In sum, what is suitable and in the best interest of a particular client depends entirely on the client's specific needs and is ultimately defined by the investment management agreement between the adviser and the client.[8] Rather than attempting to prescribe in the Proposed Interpretation a list of factors making up a client's "investment profile, " we recommend that the Commission simply state that an investment adviser must make a reasonable inquiry into its client's investment needs and that what is reasonable will depend on the facts and circumstances of the particular client and the nature and complexity of the proposed investment advice.

B. Duty of Loyalty

In its discussion of the duty of loyalty, the Proposed Interpretation states that in seeking to meet its duty of loyalty "an adviser must make full and fair disclosure to its clients of all material facts relating to the advisory relationship. In addition, an adviser must seek to avoid conflicts of interest with its clients, and, at a minimum, make full and fair disclosure of all material conflicts of interest that could affect the advisory relationship. The disclosure should be sufficiently specific so that a client is able to decide whether to provide informed consent to the conflict of interest."[9] We agree with these general statements by the Commission, but we are concerned that ambiguities throughout the Proposed Interpretation's discussion of the duty of loyalty could be read to deviate from well-established law and practice.

Specifically, the Proposed Interpretation discusses at length when an investment adviser can infer or accept client consent to a conflict. The Commission explains that an adviser would violate its fiduciary duty if it infers or accepts consent to a conflict where "(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 cannot be fully and fairly disclosed."[10] Disclosure of a conflict alone, according to the Proposed Interpretation, is not always sufficient to satisfy the adviser's duty of loyalty. In explaining its view, the Commission suggests that in some cases the nature of the conflicts may mean that disclosure cannot "adequately convey the material facts or the nature, magnitude and potential effect of the conflict. . . ." or "disclosure may not be specific enough for clients to understand whether and how the conflict will affect the advice they receive."[11] The Commission expects that in such instances advisers will eliminate the conflict or adequately mitigate the conflict so that it can be more readily disclosed.

While we agree completely with the Commission that an adviser must seek to avoid conflicts of interest with its clients, and, at a minimum, make full and fair disclosure to its clients of all material conflicts of interest that could affect the advisory relationship, we are concerned that the Commission's suggestion that disclosure may not be an effective mechanism to address some conflicts of interest threatens to undermine significantly

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[8] Note that institutional and highly sophisticated clients typically conduct a great deal of due diligence on the relevant investment strategy, beginning with a request for proposal (RFP), following by a lengthy series of meetings before entering into an agreement with the adviser.
[9] *Id.*at 15-16.
[10] *Id.* at 18.
[11] *Id.*

widely adopted practices in the asset management industry. Moreover, we are concerned that the resulting pressure on firms to attempt to comply with this aspect of the Proposed Interpretation (specifically including firms like AllianzGI that are marketing innovative, alternative strategies to clients that tend to be more complex) could harm investors, by reducing investor choice, which can lead to poor investment outcomes.

In our view, which is informed by our experience as a large, relatively complex global organization that designs and markets the types of complex, innovative strategies the Commission may have in mind, the Commission's concerns about the ability of firms to adequately disclose conflicts is unfounded. While additional effort may be required in the disclosure of a particularly complex conflict to a client, we have not encountered a situation in which we could not fully and fairly disclose the material facts, including the nature, extent, magnitude and potential effects of the conflict. To the extent the Commission has identified cases in which it appears clients did not understand certain conflicts, we believe such cases likely resulted from a failure by the adviser to provide full and fair disclosure, rather than the complex nature of the conflicts.

Therefore, we recommend that the Commission clarify that an adviser will satisfy its duty of loyalty by (i) attempting to avoid or mitigate any conflict of interest with its clients and (ii) for those conflicts that cannot be avoided or mitigated entirely, fully and fairly disclosing those conflicts to its clients.

We also recommend that the Commission confirm that advisers are not required to obtain express consent. The Proposed Interpretation creates some ambiguity in that regard in stating that "[a] client's informed consent can be explicit or, depending on the facts and circumstances, implicit." While we of course agree that express consent can be obtained, an investment adviser should be able to conclude that a client has provided informed consent if the adviser has provided full and fair disclosure of the conflict to the client through Form ADV (or in other disclosures) and the client has decided to enter into or continue the investment advisory relationship with the adviser.

II. Comment on Codification of the Proposed Interpretation

The Commission has asked whether it would be beneficial for investors to codify any portion of the Proposed Interpretation of the fiduciary duty under section 206 of the Advisers Act.[12] In our view attempting to reduce the investment adviser's fiduciary duty to a prescriptive statutory rule would be neither wise nor necessary. The fiduciary duty is flexible in nature. It is principles-based, established on equitable common law principles and shaped by decades of case law, all of which could be undermined inadvertently by codification.

Flexibility is the fiduciary duty's core strength. It follows "the contours of the relationship between the adviser and its client, and the adviser and its client may shape that relationship through contract when the client receives full and fair disclosure and

[12] *Id.* at 20.

provides informed consent," meaning "the application of the fiduciary duty will vary with the terms of the relationship…"[13] As the asset management industry has grown and evolved tremendously in size and complexity, the flexible, principles-based nature of the fiduciary duty has ensured its continued effectiveness. An attempt to codify the fiduciary duty in statutory text would almost certainly limit its flexibility, possibly leading to a weaker fiduciary duty that cannot adapt quickly enough to respond to the rapidly evolving asset management landscape.

In conclusion, AllianzGI supports changes to financial regulation that enhance investor confidence, protect investor choice and facilitate savings and outcome-oriented investing. We are pleased the Commission has decided to reaffirm the fiduciary duty standard under the Advisers Act, which has served for over a half century as a critical foundation in the regulatory framework designed to protect the interests of clients of investment advisers. Our comments are designed to help the Commission refine its interpretation of the fiduciary duty, to ensure that the best interests of our clients are supported long into the future.

We thank the Commission again for giving AllianzGI an opportunity to comment on this important topic.

Sincerely,

/Doug Eu/

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[13] *Id.*