August 31, 2017

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

Re: Standards of Conduct for Investment Advisers and Broker-Dealers

Dear Chairman Clayton:

The Investment Adviser Association[1] appreciates the opportunity to respond to your request for comment on the standards of conduct for investment advisers and broker-dealers.[2] We represent SEC-registered investment advisers, each of which provides investment advice to clients as a fiduciary under the Investment Advisers Act of 1940 (Advisers Act). Investment advisers help more than 35.6 million individual and other investors[3] plan for their financial goals, including investing for retirement, education, and buying a home. The fiduciary duty to which advisers are subject serves as a bedrock principle of investor protection.[4]

The IAA strongly supports the fiduciary standard and has long advocated that financial professionals providing investment advice about securities to clients be required to act pursuant to fiduciary principles in the best interest of their clients. We have participated actively in the regulatory and legislative consideration of the application of the fiduciary standard and commend you and your fellow Commissioners for your thoughtful consideration of this important issue.[5]

[1] The IAA is a not-for-profit association dedicated to advancing the interests of SEC-registered investment advisers. The IAA's more than 640 member firms manage more than $20 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. For more information, please visit our website: www.investmentadviser.org.

[2] Public Statement by Chairman Jay Clayton, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers* (June 1, 2017).

[3] *See* *2017 Evolution Revolution, A Profile of the Investment Adviser Profession*.

[4] Since its founding in 1937, the IAA has been the leading voice in promoting high standards of ethical and fiduciary responsibility for the investment advisory profession. *See* *IAA Standards of Practice*.

[5] For a history of our participation in this debate, please visit the Key Issues section of our website.

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A. Summary of Position

In your public statement, you noted that the Commission has previously considered a broad range of potential actions on this issue, including: (i) maintaining the existing regulatory structure; (ii) requiring enhanced disclosures; (iii) developing a best interest standard of conduct for broker-dealers; and (iv) pursuing a single standard of conduct that would "harmonize" investment adviser and broker-dealer regulations. For the reasons discussed below, we recommend that the SEC pursue the third option—developing a best interest standard for brokers that is as robust as the fiduciary standard.

Consumer advocates and industry participants alike agree that fiduciary principles are stronger than suitability rules alone.[6] As years of study demonstrate, however, considerable investor confusion persists regarding the different standards of care that apply to investment advisers and broker-dealers. Clients have long expected that their financial professional is acting in their best interest. In our view, the existing regulatory structure only exacerbates investor confusion. This includes permitting certain financial professionals to hold themselves out to clients in a manner that implies a "relationship of trust and confidence"[7] while disclaiming fiduciary responsibility to such clients. Maintaining the existing regulatory structure – the first option listed above – will do nothing to enhance investor protection or lessen this confusion. All participants in this longstanding discussion have agreed that investors should receive investment advice that is in their best interest.

We also oppose an approach that would only require enhanced disclosures. While disclosure is critical, it is not sufficient. Simply put, persons providing investment advice to clients must always be guided by the duty of loyalty and should be required to put their clients' interests above their own notwithstanding any conflict. Moreover, pursuing a single "harmonized" standard of conduct also would not effectively serve investors because it would result in a weakening or "watering down" of the existing robust fiduciary standard applicable to investment advisers. Any discussion of a uniform standard has tended toward applying broker-dealer rules to investment advisers in lieu of applying overarching fiduciary principles to brokers—an outcome the IAA strongly opposes. The Advisers Act and the fiduciary standard have provided a robust framework for advisory activities that have served clients well for over 75 years. Accordingly, the SEC should refrain from modifying the Advisers Act fiduciary duty.

We therefore urge the SEC to focus its efforts on the standard of care for brokers and refrain from rulemaking that would affect the robust fiduciary principles already embodied in the

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[6] *See* IAA Comment Letter to SEC *Re: Study Regarding Obligations of Brokers, Dealers, and Investment Advisers*, n. 23 (Aug. 30, 2010).

[7] *See* *Study on Investment Advisers and Broker-Dealers* (Jan. 2011) (2011 Study), at 54 and n. 244 (noting that courts have generally held that persons who have a "relationship of trust and confidence" with their customers owe those customers a fiduciary duty).

Advisers Act or that would simply require enhanced disclosures. Specifically, we recommend that the Commission take the following actions:

- Preserve the fiduciary duty standard under the Advisers Act, which encompasses the important principles of loyalty and care.

- Affirm that all persons who provide discretionary investment advice to clients – regardless of the form of compensation – or who provide advice for a fee, are subject to the fiduciary duty standard under the Advisers Act with respect to that advice.

- Adopt a new best interest standard of conduct under the Securities Exchange Act of 1934 (Exchange Act) for broker-dealers when making nondiscretionary investment recommendations to retail customers that is no less stringent than the Advisers Act fiduciary standard and that similarly encompasses the overarching principles of loyalty and care.

- To the extent that the Commission does not adopt an equally stringent standard under the Exchange Act, it should prohibit firms or individuals that are not subject to the Advisers Act fiduciary standard from holding themselves out in a manner that implies a fiduciary relationship.

Below we provide background regarding the fiduciary duty and the Commission's consideration of whether to apply it to broker-dealers, followed by our recommendations. We welcome the opportunity to engage with the Commission and its staff to discuss our views and to provide additional detail regarding our recommendations.

B. Background

Investor Confusion Persists

For many years, a bright line separated traditional brokerage services from traditional investment advisory services. For over two decades now, however, broker-dealers have increasingly moved toward more traditional investment advisory activities, such as offering investment and retirement planning services. This movement has resulted in a blurring of the line and increased investor confusion. While both investment advisers and broker-dealers provide investment advice to retail investors, they operate under different business models and significant differences remain between the core business activities of investment advisers (*i.e.*, those that are solely engaged in the business of providing investment advice) and broker-dealers (*i.e.*, those that effect securities transactions). Brokers provide investment advice in addition to trade execution and other services but are not subject to the laws primarily governing investment advice. Unfortunately, studies have shown that investors may not fully understand or appreciate these differences, including with respect to the applicable standard of conduct.[8] Indeed, investors have overwhelmingly believed that those who give investment advice are – and should be – required to act in the best interests of their customers without regard to their own interest. Investment advisers are subject to such a duty with respect to all advisory accounts; broker-dealers are not.

Existing Legal Framework

The well-established fiduciary duty under the Advisers Act, which incorporates both a duty of loyalty and a duty of care, has been applied consistently over the years by courts and the SEC.[9] This stringent overarching duty, which requires investment advisers at all times to act in the best interest of clients and to place the interests of clients before their own, is a core principle of the ongoing investment adviser-client relationship.

We have consistently taken the position that the fiduciary standard should apply to all professionals in the business of providing investment advice about securities to clients. This standard applies to all SEC-registered advisers, whether they provide in-person or automated investment (robo) advice, retirement or non-retirement advice, or retail or institutional advice. However, under current law, broker-dealers are excluded from the Advisers Act and its fiduciary duty if they provide investment advice "solely incidental" to the conduct of their business as a broker-dealer and receive no "special compensation" for such services (broker-dealer exclusion).[10] Instead, they are subject to a separate regulatory framework under the Exchange Act. Under this separate framework, broker-dealers must ensure that the advice they give is "suitable" for the customer based on the customer's investment objectives and profile, and they must "observe high standards of honor and just and equitable principles of trade."[11] While this standard may reflect a duty of care, it does not incorporate other key elements of the Advisers Act fiduciary duty, including a duty of loyalty, which is a critical aspect of a true best interest standard. Broker-dealers are thus held to a standard of fair treatment reflecting a commercial transaction-based arrangement rather than an ongoing relationship of trust and confidence, as contemplated by the Advisers Act.

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[8] *See* RAND Institute, *Study on Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008) (Rand Study).

[9] The Advisers Act defines "investment adviser" as "any person who, for compensation, engages in the business of advising others, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." Section 202(a)(11).

[10] The Advisers Act provides an exception from the definition of investment adviser for "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." Section 202(a)(11)(B).

[11] FINRA Rule 2010.

The SEC's Consideration of the Issue

The SEC has previously considered whether broker-dealers giving investment advice should be subject to the same fiduciary duty as investment advisers. As broker-dealers migrated toward asset-based fees and providing advisory services, they urged the SEC to adopt a rule to expand the scope of the broker-dealer exclusion by permitting them to receive fee- or asset-based compensation.[12] In 1999, the SEC first proposed and in 2005 it adopted a rule under the Advisers Act that provided that a broker-dealer will not be deemed to be an investment adviser if it receives "special compensation," as long as its advice is solely incidental to brokerage services and specific disclosure is made to its customer.[13] The final rule was challenged and vacated by the D.C. Circuit Court of Appeals in 2007.[14] The court held that the SEC did not have authority under the Advisers Act to eliminate the "special compensation" prong of the broker-dealer exclusion. The court did not overturn certain pro-investor aspects of the SEC rule, however, and we strongly supported the Commission's proposal to reaffirm certain of those aspects through issuance of an interpretive rule.[15] Most significantly, the proposed interpretive rule would have confirmed that discretionary investment advice is not solely incidental to the business of a broker-dealer, regardless of the form of compensation charged.[16] The Commission did not issue a final interpretive rule. Instead, it focused on the results of a study it had commissioned on the marketing, sale, and delivery of financial products and services to investors from the perspectives of industry practices and investors' understanding.[17]

The Financial Crisis and the Dodd-Frank Act

The 2008 financial crisis intervened and Section 913 of the Dodd-Frank Act articulated a potential framework for the SEC to consider how to address investor confusion and the appropriate standard of conduct for the provision of investment advice to retail investors. The

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[12] *Certain Broker-Dealers Deemed Not To Be Investment Advisers*, Release Nos. 34-42099; IA-1845, n. 13 (Nov. 4, 1999).

[13] Advisers Act Rule 202(a)(11)-1 (vacated).

[14] *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007) (*FPA* Case).

[15] *See* IAA Comment Letter *Re: Interpretive Rule under the Advisers Act Affecting Broker-Dealers*, Rel. No. IA-2652, File No. S7-22-07 (Nov. 2, 2007).

[16] *Interpretive Rule under the Advisers Act Affecting Broker-Dealers*, Rel. No. IA-2652, File No. S7-22-07 (Nov. 2, 2007).

[17] *See* Rand Study, *supra* note 8.

SEC staff study required under Section 913 was completed in 2011 and recommended adoption of parallel rules imposing a uniform fiduciary duty on broker-dealers and investment advisers.[18]

To further its analysis of this important issue, the Commission published a request in 2013 for data and other information concerning various aspects of the provision of individualized investment advice to retail customers.[19] In our response, the IAA reiterated our longstanding view that the fiduciary standard is the right standard to apply to all professionals in the business of providing investment advice to clients.[20] However, we expressed concern that the SEC's request for information signaled an inclination to impose ill-fitting broker-dealer rules on advisers and water down the Advisers Act fiduciary standard.

The Department of Labor's Fiduciary Rule

Since that time, the Department of Labor (DOL) adopted a fiduciary rule that significantly expanded the concept of nondiscretionary investment advice, in part through its definition of "recommendation." Investment professionals providing discretionary retirement advice have always been fiduciaries under Section 3(21)(A)(1) of the Employee Retirement Income Security Act of 1974 (ERISA). Moreover, SEC-registered investment advisers providing advice to ERISA plans and individual retirement accounts (IRAs) have also always been fiduciaries under the Advisers Act. Now, however, broker-dealers that make investment recommendations to ERISA plans and IRAs are also considered fiduciaries in connection with that advice.

We appreciate the Commission's renewed interest in addressing these difficult and complex issues. Our recommendations are discussed below.

C. Recommendations

1. Preserve the robust fiduciary duty standard under the Advisers Act.

The Advisers Act provides a comprehensive regulatory framework for the provision of investment advice to all clients of investment advisers, and the foundation of this framework is the principles-based fiduciary duty owed to all clients. This duty was recognized by the Supreme Court in 1963, when it held that the Advisers Act "reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship, as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment

[18] 2011 Study, *supra* note 7.

[19] *Request for Data and Other Information*, Rel. No. 34-69013; IA-3558 (Mar. 1, 2013) (2013 Request).

[20] *See* IAA Comment Letter, *SEC Request for Data and Other Information*, Rel. No. 34-69013; IA-3558; File No. 4-606 (July 3, 2013).

adviser – consciously or unconsciously – to render advice which was not disinterested."[21] The Court further stated that investment advisers have "an affirmative duty of 'utmost good faith and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' … clients." This well-established standard has been consistently interpreted and applied by the SEC and the courts to require investment advisers to serve their clients with the highest duty of loyalty and care.[22]

The fiduciary standard is based on common law principles arising from the relationship of trust and confidence between the adviser and the client, broadly requiring that an investment adviser act with the highest duty of loyalty and care, rather than under a set of detailed and prescriptive rules. This has resulted in a fiduciary duty that is flexible and that has provided an effective framework for advisers serving a broad spectrum of clients across an expansive range of investment approaches for many decades. This flexibility also allows the standard to cover emerging investment technologies while retaining the overarching fiduciary principles.[23]

While it is principles-based, specific obligations flow from this duty, including the duty to: make full and fair disclosure to clients of all material facts; place the clients' interests first; have an adequate, reasonable basis for its investment advice; inform itself about clients' situations and circumstances; use only those strategies for which the adviser is reasonably competent; seek best execution for clients' securities transactions where the adviser directs such transactions; render advice that is suitable to clients' needs, objectives, and financial circumstances; allocate investment opportunities fairly among clients; not subrogate clients' interests to its own; not use client assets for itself; and maintain client confidentiality.[24] Moreover, when the interests of an adviser differ from those of its clients, the adviser must act to either eliminate the conflict or mitigate the conflict and fully explain it to the client.[25] While disclosure of conflicts is crucial, it cannot take the place of the overarching duty of loyalty. In other words, an adviser is still first and foremost bound by its duty to act in its client's best

[21] *See SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 196 (1963).

[22] *See, e.g., Proxy Voting by Investment Advisers*, Investment Advisers Act Rel. No. IA-2059 (Sept. 20, 2002) ("An adviser's fiduciary duty includes the duty of care and the duty of loyalty to clients.").

[23] For example, the SEC staff has issued important guidance regarding application of the fiduciary duty and other Advisers Act obligations to robo-advisers. *See* *Robo-Advisers*, Guidance Update from the SEC's Division of Investment Management No. 2017-02 (Feb. 2017) ("Robo-advisers, like all registered investment advisers, are subject to the substantive and fiduciary obligations of the Advisers Act."); *see also* Jennifer Klass and Eric Perelman, Morgan, Lewis & Bockius LLP, *The Evolution of Advice: Digital Investment Advisers as Fiduciaries*.

[24] *See* 2011 Study, *infra* note 7.

[25] *See, e.g.,* Speech, *Conflicts, Conflicts Everywhere*, by Julie M. Riewe, Co-Chief, Asset Management Unit, Division of Enforcement (Feb. 26, 2015).

interests and disclosure does not relieve an adviser of this duty.[26]

Because the Advisers Act standard has worked well for advisers and their clients for so long, we would strongly oppose any changes to it, including any attempt to "harmonize" it with the broker-dealer's suitability standard, which likely would dilute the Advisers Act standard by trying to find a "middle-ground." We would also oppose "harmonization" because it would *dis*harmonize the application of the Advisers Act. The fiduciary standard under the Advisers Act protects retail *and* institutional clients equally. The perverse result of changing the Advisers Act standard for retail clients would be to make the new standard weaker than the standard that would continue to apply to institutional clients.

As we discuss below, we believe that the Commission can and should develop a separate principles-based best interest standard of conduct for broker-dealers under the Exchange Act tailored to the core activities of broker-dealers that is as strong as the Advisers Act standard.

2. **Affirm that all persons who provide discretionary investment advice – regardless of the form of compensation – or provide advice for a fee, are subject to the fiduciary duty standard under the Advisers Act with respect to that advice.**

We urge the Commission to formally reaffirm that all persons who provide discretionary investment advice, regardless of the form of compensation they receive, are subject to the Advisers Act. We have long agreed with the Commission's 2007 proposed interpretation that discretionary investment advice cannot be deemed "solely incidental" to brokerage services, and persons who provide such advice must be registered as investment advisers and be subject to the Advisers Act with respect to that advice.

We also urge the Commission to codify its long-held view that "when a broker-dealer charges its customers a separate fee for investment advice, it clearly is providing advisory services and is subject to the Advisers Act."[27] Although the Commission's proposed interpretations were not finalized, we believe it is important to formalize these two positions to

[26] *See* Paul F. Roye, Director, Division of Investment Management, *Maintaining the Pillars of Protection in the New Millennium*, Address Before the Investment Company Institute (May 21, 1999) ("Section 17(a) [of the Investment Company Act] seeks to protect the fiduciary relationship by deeming it better to foreclose principal transactions rather than attempt to separate the beneficial and harmful transactions and allow the fiduciary to justify representation of two conflicting interests. Section 17(a) also reflects the common law theory that disclosure alone cannot satisfy the duty of loyalty of a fiduciary."); *Reed v. Robilio*, 273 F. Supp. 954 (W.D. Tenn. 1967) ("Nevertheless, disclosure alone does not satisfy the fiduciary duty. The most exacting disclosure would not suffice if the price paid were grossly inadequate.").

[27] 2007 Proposed Interpretive Rule Under the Advisers Act Affecting Broker-Dealers, 72 Fed. Reg. at 55128.

eliminate any confusion as to the status of discretionary or fee-based advice under the federal securities laws.

3. Adopt a new principles-based best interest standard of conduct under the Exchange Act for broker-dealers when making nondiscretionary investment recommendations that is tailored to core broker-dealer activities but is no less stringent than the Advisers Act fiduciary standard.

The services for which broker-dealers currently are subject to different standards of conduct from investment advisers are primarily nondiscretionary investment advisory services, such as making recommendations about securities or investment strategies involving securities to brokerage customers. We recommend that the Commission adopt a new best interest standard of conduct, under Section 15(l) of the Exchange Act, for broker-dealers when making nondiscretionary investment recommendations regarding securities to retail customers.[28] This new Exchange Act standard should codify the notion that investment recommendations constitute investment "advice." To ensure that the interests of retail investors always come first, regardless of the different business models of investment advisers and broker-dealers, this new standard should be tailored to the core activities and business models of broker-dealers but be no less stringent than the Advisers Act fiduciary standard.[29] An equally stringent standard is also necessary to reduce confusion for investors and ensure that they do not bear the burden of having uncertainty about the standard of conduct that applies to the investment professional they choose.

Consistent with the Advisers Act, the new standard of conduct for broker-dealers should be principles-based to allow it to be tailored to broker-dealers' core business activities and to provide flexibility for it to adjust to changing markets and business models through an interpretive approach. A principles-based approach will allow the overarching best interest standard to remain adaptive to new markets, technologies, and business arrangements and continue to be meaningfully protective.

This new standard would also need to incorporate the principles of loyalty and care and require appropriate and meaningful disclosures, consistent with these concepts under the

[28] We believe the Commission has authority to adopt such a standard under Section 15(l)(2) of the Exchange Act, which authorizes it to "examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors." Broker-dealers should not be permitted to provide investment advice to retail investors unless they comply with a best interest standard of conduct.

[29] This approach is consistent with Section 913 of the Dodd-Frank Act, which authorizes the SEC to establish a standard of conduct that applies to broker-dealers when providing investment advice about securities to retail investors that is "no less stringent than" the fiduciary duty standard under the Advisers Act for investment advisers.

Advisers Act. While the standard should be principles-based, it should include at a minimum certain specific requirements designed to ensure adequate and appropriate implementation of the standard.[30] Thus, for example, investment advisers must disclose to clients all material conflicts of interest and how the adviser addresses these conflicts. The investment adviser fiduciary duty requires other specific types of disclosures as well. Indeed, in the course of providing both discretionary and nondiscretionary advice to clients (including retail clients), advisers must disclose all other information material to the relationship, including the fees that they charge, how they plan to recommend securities to clients, and any material disciplinary information involving the firms or their investment personnel. Broker-dealers should be held to similarly robust standards and be required to make similarly robust disclosures under any new standard of conduct. For example, to address investor confusion about the nature of the services offered by their financial professionals, we would also expect that broker-dealers subject to the best interest standard would provide appropriate disclosures regarding the capacity, scope, duration of services, material conflicts of interest, and compensation arrangements related to those services.

A new best interest standard for broker-dealers as described above would ensure that an investor's interest is being served above all else and provide much needed clarity for investors and financial professionals alike.[31]

4. **Prohibit firms or individuals from holding themselves out in a manner that implies a fiduciary relationship if they are not required to adhere to the principles noted above.**

In considering the appropriate standard of care for broker-dealers, the Commission should carefully consider the widespread confusion over the ways that financial professionals hold themselves out to the public. As noted above, in 2008 the SEC released the results of a study that examined how investment advisers and broker-dealers market products and services to investors, and how investors understand the differences between investment advisers and broker-dealers. The study concluded, among other things, that investors generally do not understand the key distinctions between broker-dealers and investment advisers, nor do they understand the varying legal duties of and standards imposed on broker-dealers and investment advisers.

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[30] We would be pleased to assist the Commission as it works to develop the new standard to ensure that its specific contours are as investor-protective as the existing Advisers Act standard.

[31] We also welcome your commitment to work with the DOL in pursuing clear and consistent standards of conduct applicable to financial professionals. In addition, we note the recent further confusion created by certain states purporting to regulate SEC-registered advisers notwithstanding preemption of such regulation by the National Securities Markets Improvement Act of 1996 (NSMIA). *See, e.g.,* Nevada Senate Bill No. 383, 79th Sess. (2017) (imposing a fiduciary duty on certain investment advisers and broker-dealers).

We believe that investor confusion persists where certain financial professionals are permitted to use terms such as “financial adviser” or “financial advisor” that imply a relationship of trust and confidence but, in effect, disclaim fiduciary responsibility for such a relationship. We urge the Commission to address this source of investor confusion by prohibiting firms or individuals from holding themselves out as trusted advisers without being subject to either the Advisers Act fiduciary principles or a new equally stringent best interest standard under the Exchange Act, discussed above. We also believe that the Commission should play a central role in educating the investing public about the significant differences in business models and practices between investment advisers and broker-dealers irrespective of their applicable standards of conduct and stand ready to assist in this critical initiative.[32]

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We appreciate the opportunity to provide our views regarding this important investor protection issue and would welcome the opportunity to meet with you to discuss our recommendations. In the meantime, please do not hesitate to contact me at (202) 293-4222 if we may provide any additional information.

Respectfully,

Gail C. Bernstein
General Counsel

cc: The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner
David W. Grim, Director, Division of Investment Management
Heather Seidel, Acting Director, Division of Trading and Markets

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[32] For example, we would be pleased to work with the SEC’s Office of Investor Education and Advocacy to update and/or develop educational materials. *See, e.g.*, Office of Investor Education and Advocacy Investor Bulletins: *Top Tips for Selecting a Financial Professional* (April 25, 2016); SEC-NASAA Investor Bulletin, *Making Sense of Financial Professional Titles* (Sept. 1, 2013). *See also* North American Securities Administrators Association, IAA, Financial Planning Coalition, and CFA Institute, *Cutting through the Confusion: Where to Turn for Help with Your Investments*.