INVESTMENT ADVISER
ASSOCIATION

October 9, 2013

Via Electronic Filing

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

RE: Recommendation Concerning Broker-Dealer Fiduciary Duty by the Investor Advisory Committee's Subcommittee on the Investor as Purchaser, File No. 265-28

Dear Ms. Murphy:

The Investment Adviser Association (IAA)[1] greatly appreciates the opportunity to respond to the proposed Recommendations on Broker-Dealer Fiduciary Duty made by the Investor as Purchaser Subcommittee of the Commission's Investor Advisory Committee (IAC) to be discussed at a future meeting of the IAC. We represent investment adviser firms registered with the Commission under the Investment Advisers Act of 1940 (Advisers Act), each of which provides investment advice to its clients under a fiduciary standard. We commend the Subcommittee for its thorough analysis of this important issue, and urge the Committee to adopt the Subcommittee's recommendation that the Securities and Exchange Commission (SEC) conduct a rulemaking to subject broker-dealers providing investment advice to a fiduciary standard.

We have long maintained that the fiduciary standard, including the important principles of trust, loyalty, and duty of care, is the right standard to apply to all professionals in the business of providing investment advice to clients.[2] The federal fiduciary standard requires investment advisers to act in the best interests of clients and to place their clients' interests before their own. The Advisers Act and the fiduciary standard provide an extensive framework for conduct and compliance, and we believe that all investors receiving investment advice should receive the full

[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms that are registered with the SEC. For more information, please visit our web site: www.investmentadviser.org.

[2] We expressed our support for the fiduciary standard most recently in our July response to the SEC's March 1 Request for Data and Other Information on the fiduciary standard. This submission sets out our position in detail and tracks the IAA's previous testimony and comment letters on this topic, and we attach this response for the IAC's consideration.

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benefit of these fiduciary protections. Indeed, we share the concerns of the Subcommittee that any SEC rulemaking not weaken the existing protections for advisory clients.

Although for many years a bright line separated traditional brokerage services from traditional investment advisory services, broker-dealers have moved toward offering more traditional investment advisory activities and marketing themselves as "advisors," resulting in a blurring of this line. Under current law, however, a broker-dealer whose performance of advisory services is "solely incidental" to the conduct of its business as a broker-dealer and who receives no "special compensation" for such services currently is excluded from coverage under the Advisers Act and its overarching fiduciary duty. Brokerage clients therefore do not receive the protection of their financial professional being subject to a principles-based duty to act in their best interests.

Accordingly, we urge the IAC to recommend that the SEC take action to ensure that investors receiving investment advice are entitled to the Advisers Act fiduciary standard.

Please contact the undersigned, Karen L. Barr, General Counsel, or Kathy D. Ireland, Associate General Counsel, at (202) 293-4222 with any questions regarding these matters.

Respectfully submitted,

David G. Tittsworth
Executive Director

cc: The Hon. Mary Jo White, Chair
Joseph Dear, Chairman, Investor Advisory Committee
Barbara Roper, Chairman, Investor as Purchaser Subcommittee

Enclosure

INVESTMENT ADVISER
ASSOCIATION

July 3, 2013

Via Electronic Filing

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Request for Data and Other Information, Rel. No. 34-69013; IA-3558; File No. 4-606

Dear Ms. Murphy:

The Investment Adviser Association (IAA)[1] greatly appreciates the opportunity to provide data and other information in connection with the Commission's consideration of standards of conduct for broker-dealers and investment advisers providing personalized investment advice to retail customers.[2] We represent investment adviser firms registered with the Commission under the Investment Advisers Act of 1940 (Advisers Act), each of which provides investment advice to its clients under a fiduciary standard. We have long held the position that the fiduciary standard, which encompasses the important principles of trust, loyalty, and duty of care, is the right standard to apply to all professionals in the business of providing investment advice to clients, and have participated actively in legislative and regulatory consideration of the application of the fiduciary standard to financial professionals who provide investment advice.[3]

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[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms that are registered with the SEC. For more information, please visit our web site: www.investmentadviser.org.

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

[3] *See, e.g., Hearing on Capital Markets Regulatory Reform: Strengthening Investor Protection, Enhancing Oversight of Private Pools of Capital, and Creating a National Insurance Office Before the H. Comm. on Fin. Servs*. 111th Cong. (Oct. 6, 2009) (statement of David G. Tittsworth, Executive Dir. and Executive Vice President, IAA); *Enhancing Investor Protection and the Regulation of Securities Market Hearing Before the S. Comm. on Banking, Hous. and Urban Affairs 111th Cong.* (Mar. 26, 2009) (statement of David G. Tittsworth, Executive Dir. and Executive Vice President, IAA); Letter from Consumer Federation of America, et al., to Mary L. Schapiro, Chairman, SEC, re: Framework for Rulemaking under Section 913 of the Dodd-Frank Act (Mar. 28, 2012) (March 2012 Joint Letter); Letter from David G. Tittsworth, Executive Dir. and Executive Vice President, IAA to Elizabeth M. Murphy, Secretary, SEC, re: Rel. No. IA-3058 Study Regarding Obligations of Brokers, Dealers, and Investment Advisers (Aug. 30, 2010) (IAA Comment Letter on SEC Study); Letter from David G. Tittsworth, Executive Dir., IAA, to Jonathan Katz, Secretary, SEC, re: Rel. No. IA-2278 Certain Broker-Dealers Deemed Not to be Investment

We continue to maintain that all persons providing investment advice about securities to clients (regardless of the level of the client's sophistication) should be subject to the same high standard of care – the well-established fiduciary duty standard under the Advisers Act. This federal fiduciary standard requires investment advisers to act in the best interests of clients and to place the interests of clients before their own. The Advisers Act and the fiduciary standard provide an extensive framework for conduct and compliance and impute an overarching duty on the part of investment advisers to put the interests of their clients first. We take seriously the Commission's consideration of the appropriate standard to apply in the retail client context; however, we are concerned that the Commission's Request signals an inclination to "water down" the Advisers Act fiduciary standard by suggesting that disclosure alone would satisfy its requirements or by reducing the overarching duty to a prescribed set of rules. We would oppose any effort that would result in a lesser standard for any group of investment advisers than exists today.

In addition, we are concerned that the Commission appears to be approaching its initial consideration of the uniform standard of conduct and other regulatory harmonization from the perspective of applying broker-dealer rules to investment advisers, while only sparingly mentioning the possibility that investment adviser regulation should apply to brokers that provide advice. We would oppose wholesale application of "check-the-box" broker-dealer regulation to investment advisers. Despite a blurring of the lines as some broker-dealers have moved toward advisory activities, significant differences remain between the core activities of most broker-dealers (*i.e.,* those who effect securities transactions and are generally referred to as the "sell side") and investment advisers (*i.e.*, those who are solely engaged in the business of providing investment advice and are referred to as the "buy side").[4] Imposing the broker-dealer rule set on investment advisers would fail to recognize those fundamental differences and would impose substantial costs with no corresponding investor protection benefits. Further, such an approach fails to appreciate the breadth and scope of the fiduciary duty and Advisers Act rules.

Below we provide background regarding the fiduciary duty and the Commission's consideration of whether to apply it to broker-dealers, followed by responses to specific requests posed by the Commission in the order presented in its Request.

I. Background

For many years, a bright line separated traditional brokerage services from traditional investment advisory services. During the last two decades, however, broker-dealers have moved toward offering more traditional investment advisory activities and marketing themselves as "advisors," resulting in a blurring of this line. In recognition of this shifting landscape, since at

Advisers (Sept. 24, 2004); Letter from David G. Tittsworth, Executive Dir., ICAA, to Jonathan G. Katz, Secretary, SEC (Jan. 12, 2000).

[4] Indeed, we support extension of the Advisers Act fiduciary duty to broker-dealers only when they engage in investment advisory activities.

least 1999, the SEC has engaged in rulemakings and other activities regarding the standard of care for broker-dealers giving investment advice.[5]

Section 913 of the Dodd-Frank Act

Retail investors expect that their securities professionals will act in their best interests; they are understandably confused that a different standard applies to broker-dealers who give them advice.[6] The provisions of Section 913 of the Dodd-Frank Act reflect congressional concern about this confusion. Section 913 requires the SEC to conduct a study to evaluate the effectiveness of existing legal or regulatory standards of care for broker-dealers, investment advisers, and their associated persons in providing personalized investment advice about securities to retail customers and whether there are gaps, shortcomings, or overlaps in those standards.[7]

The Dodd-Frank Act further authorizes the SEC to conduct a rulemaking to address the legal or regulatory standards of care for broker-dealers and investment advisers, taking into account the findings of the study. Under the provisions of Section 913, the SEC may impose on brokers providing advice to retail customers (or such other customers as the SEC may by rule provide) the same standard of conduct applicable to advisers under section 211 of the Advisers Act. Section 913 also provides that any standard of conduct promulgated under section 211 shall be *no less stringent than* the standard of care under Advisers Act sections 206(1) and (2).

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[5] The SEC sought to address these concerns with a rulemaking, but the rule was subsequently vacated after a legal challenge. The SEC adopted Advisers Act rule 202(a)(11)-1 to exclude certain broker-dealers offering fee-based brokerage accounts from the Advisers Act. *See* Certain Broker-Dealers Deemed Not to be Investment Advisers, Investment Advisers Act Rel. No. IA-2376 (Apr. 12, 2005). The Financial Planning Association (FPA), however, opposed it and filed suit against the SEC to vacate the rule. The SEC had originally proposed a similar rule in 1999, which also was opposed by the FPA because, among other things, the proposing release embedded a no-action position to create an immediate exception to the definition of broker-dealer. The FPA filed suit against the SEC, and, in response, the SEC withdrew the original proposed rule and reproposed the rule, which was adopted in 2005. In 2007, the D.C. Circuit vacated the SEC's rule on the grounds that the agency lacked the authority to except broker-dealers offering fee-based brokerage accounts from the definition of investment adviser. *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007). Then in 2008, the SEC contracted with the RAND Corporation to study how the different regulatory systems that apply to broker-dealers and investment advisers affect investors.

[6] *See, e.g.,* Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, et al., to Mary L. Schapiro, Chairman, SEC, re: Survey: Vast Majority of U.S. Investors Support Clear "Fiduciary Standard" for Financial Professionals; Widespread Confusion Seen Linked to Current SEC Rules (Sept. 15, 2010) (results of a national opinion survey regarding U.S. investors and the fiduciary standard conducted by ORC/Infogroup for the Consumer Federation of America, AARP, the North American Securities Administrators Association, the Certified Financial Planner Board of Standards, Inc., the Investment Adviser Association, the Financial Planning Association and the National Association of Personal Financial Advisors); Angela A. Hung, Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, Farrukh Suvankulov, *RAND Report: Investor and Industry Perspectives on Investment Advisers and Broker-Dealers,* at 14 (Jan. 3, 2008) (RAND Report); TD AMERITRADE Investor Perception Study 2006 ("If investors knew that stockbrokers provided fewer investor protections than investment advisors, 63% would not seek financial advice from them.").

[7] We provided recommendations concerning the SEC's study in 2010, and incorporate herein the contents of this earlier comment letter by reference. IAA Comment Letter on SEC Study, *supra* note 3.

The Commission staff issued the required study in 2011,[8] and recommended the adoption of parallel rules imposing a uniform fiduciary duty on broker-dealers and investment advisers. To further its analysis of this important issue, the Commission issued the Request, which seeks data and other information concerning various aspects of the provision of individualized investment advice to retail customers.

The Fiduciary Standard

As we discuss in detail below, we are concerned that the fiduciary duty contemplated by the Request falls well short of the "no less stringent" standard set out by Congress. The Request does not appear to fully incorporate the most crucial aspect of fiduciary duty – the overarching duty to act in the client's best interests. This duty, to put the client's interests first, is at the heart of the fiduciary approach and informs an adviser's conduct in every situation. By not recognizing the importance of this aspect of the fiduciary standard, the assumptions discussed in the Request imply a lesser standard. Indeed, the Request seems to contemplate simply adding disclosure requirements to existing broker-dealer rules and labeling the result a fiduciary standard. We would strongly oppose such an approach as not reflecting the fundamental principles embedded in a fiduciary standard or the specific requirements of Section 913.

The fiduciary duty under the Advisers Act was first articulated by the U.S. Supreme Court in 1963.[9] The Court found embodied in the Advisers Act an adviser's affirmative duty of utmost good faith and full and fair disclosure of all material facts to its clients, as well as an affirmative obligation to employ reasonable care to avoid misleading its clients.[10] 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.[11]

The fiduciary standard is based on common law principles arising from the relationship of trust between the adviser and the client, rather than a comprehensive set of detailed rules. This has resulted in a fiduciary duty that is flexible and has provided an effective framework for advisers serving a broad spectrum of clients across an expansive range of investment approaches

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[8] Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) (913 Study).

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

[10] *Id.* These duties of a fiduciary were applied by the SEC and the courts long before the Supreme Court in the *Capital Gains* case found them to be embodied in the anti-fraud provisions of the Advisers Act. *See, e.g., In the Matter of Arleen W. Hughes*, Exchange Act Rel. No. 4048 (Feb. 18, 1948).

[11] *See, e.g., Capital Gains, supra* note 9; *Goldstein v. SEC*, 451 F.3d 873, 881 (D.C. Cir. 2006); *In the Matter of Kidder, Peabody & Co.*, Investment Advisers Act Rel. No. 232 (Oct. 16, 1968); 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"); *Beacon Hill CBO II, LTD v. Beacon Hill Asset Management LLC,* 249 F. Supp. 2d 268, 273 (S.D.N.Y. 2003); Thomas Lemke & Gerald Lins, Regulation of Investment Advisers, at § 2:33 (2013); Arthur Laby, *SEC v. Capital Gains Research Bureau and the Investment Advisers Act of 1940*, 91 B.U. L. Rev. 1051, 1085 & 1098 (2011).

for many decades. The fiduciary standard is by its nature "scalable" in that the parameters of the duty depend on the scope of the advisory relationship.[12]

Illustrations of the Fiduciary Standard

The following examples, drawn from our members, are illustrative of how advisers apply the fiduciary standard to their day-to-day advisory services:

Tone at the Top

As a general matter, investment advisers recognize the importance of "tone at the top" in establishing a fiduciary culture, which informs all firm personnel in the conduct of their duties. The message conveyed by senior management to firm personnel in written policies and procedures, codes of ethics and conduct, and regular training, is that the clients' best interests are the main concern of the firm. "Tone at the top" guides each firm's decision-making in addressing all aspects of its business, including the establishment of policies in areas that are not addressed specifically in SEC rules. These policies are monitored and reviewed to ensure that the adviser is serving the best interests of its clients.

Personal Trading

"Best interests of the client" influences a firm's policies and procedures in many areas, including personal trading by the firm's employees. For example, although not required by SEC rules, firms may impose "blackout" periods during which firm personnel cannot buy or sell securities in their personal accounts. Policies on "blackout" periods, the length of such periods, and the persons or categories of persons to whom they apply will vary to meet the particular nature and practices of individual firms; however each firm's goal is typically to avoid even the appearance that firm employees may be benefiting from the firm's recommendations to clients. These policies are enforced in various ways, including pre-clearance, employee reporting and certifications, on-going monitoring, and periodic testing.

Allocation

In addition, investment advisers under the fiduciary standard typically establish policies and procedures concerning allocation of investment opportunities, which apply when a particular investment may be appropriate for multiple clients, especially where the investment opportunity is limited. The SEC does not require

[12] *See, e.g.,* Michael Koffler, *Six Degrees of Separation: Principles to Guide the Regulation of Broker-Dealers and Investment Advisers*, 41 Sec. Reg. & Law Rep. (BNA) 776 (Apr. 27, 2009) ("The scope of a fiduciary's duty under the law necessarily and purposely varies depending on the scope of authority, the ability of entrustors to control the fiduciary, the ability of entrustors to monitor their fiduciary, the extent of power and entrustment provided to the fiduciary, the nature and extent of the services provided by the fiduciary and various other factors.").

such procedures by rule;[13] however, these procedures are prevalent in the industry. In order to assure that the adviser is serving the best interests of its clients, it may establish a pro rata rule to allow all applicable clients to invest in equal amounts, or may establish a rotation system to assure that clients are treated equally over time. Firms will review trades regularly to confirm that these procedures are being followed, and that they treat all clients fairly. As part of these policies, firms may require that any proprietary trades by the firm and personal trades by firm personnel be made only after all client orders have been filled.[14]

Trade Errors

Similarly, the fiduciary standard governs investment advisers' policies on trade errors, even in the absence of a specific SEC rule on this topic. Investment advisers routinely make their clients whole when they have made a trade error. Policies and procedures address these situations, and the adviser monitors and periodically tests to confirm that the procedures are followed.

Client Guidance

The fiduciary standard applies beyond the context of policies and procedures and guides investment advisers in their day-to-day interactions with clients. For example, investment advisers working with individual clients routinely advise their clients to use their assets for purposes other than investing, even though this advice would reduce the amount of funds under the firm's management, and accordingly reduce the adviser's fee. Such instances arise when the firm advises a client to pay off his or her mortgage, make gifts for tax reasons, or engage in other estate planning measures.

As these illustrations demonstrate, the fiduciary culture of putting clients' interests first provides important investor protections. This overarching fiduciary duty cannot (and should not) be circumscribed by a specific set of rules.[15]

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[13] The Request states that a "fiduciary's duty of loyalty generally would require a firm to disclose" its allocation methodology. Request at 37-38. However, the duty of loyalty requires more than disclosure, as illustrated by firms' procedures to ensure allocations are fair and in the best interests of clients.

[14] Allocation is a good example of the flexibility and scalability of principles-based duties where firms may need different policies and procedures depending on their investment strategies. Thus, firms investing in only liquid large cap securities or open-end mutual funds for their clients would need different policies and procedures from those investing in small- or micro-cap or other less liquid securities. In addition, the allocation policies for fixed income investments often differ from those with respect to equities.

[15] *See* Koffler, *supra* note 12 ("Given the equitable nature of fiduciary law, it is not tenable to set forth a fiduciary's responsibilities in a detailed manner or to specify a convention to govern their activity. Nor would it be in the public interest to do so. And it certainly would not be consistent with the way fiduciary law has evolved and been interpreted for hundreds of years.").

II. Information Relating to the Current Market for Personalized Investment Advice

Part II of the Request asks commenters to provide data and other information concerning the specific costs and benefits associated with the current regulatory scheme as applied to particular activities. The following discussion responds to the indicated items listed in the Request.

Types and Availability of Service Offered to Retail Customers [Item 2]

Investment advisers are required to provide information on Form ADV, the SEC registration form for advisers, as to their client base and the services that they provide. According to the Investment Adviser Registration Depository (IARD) as of April 12, 2013, 52% of SEC-registered investment advisers provide investment advice to individuals other than high net worth individuals, and 60% provide investment advice to individuals who are high net worth. Half of all registered advisers reported having both high net worth and non-high net worth individuals as clients. The combination of these two categories of individuals roughly tracks the Section 913 definition of "retail customer."[16]

Of the advisers with individual clients:

- 53% provide financial planning services;
- 95% provide portfolio management for individuals and/or small businesses;
- 12% provide portfolio management for registered investment companies (as well as "business development companies" that have made an election pursuant to section 54 of the Investment Company Act of 1940);
- 19% provide portfolio management for pooled investment vehicles (other than investment companies);
- 63% provide portfolio management for businesses (other than small businesses) or institutional clients (other than registered investment companies and other pooled investment vehicles);
- 23% provide pension consulting services;
- 39% select other advisers (including private fund managers);
- 9% publish periodicals or newsletters;
- 0.3% provide security ratings or pricing services;
- 1% provide market timing services;
- 8% provide educational seminars/workshops; and
- 19% provide "other" services.

[16] Section 913(a) of the Dodd-Frank Act defines the term "retail customer" as "a natural person, or the legal representative of such natural person, who (1) receives personalized investment advice about securities from a broker or dealer or investment adviser; and (2) uses such advice primarily for personal, family, or household purposes." Although the IARD data do not reflect the way in which individuals use advice, it is reasonable to assume that most natural person clients use the investment advice they receive for personal, family, or household purposes.

This "mix" of services generally has not changed between 2007 and the present, according to information from the IARD.[17]

We also note that, as described in more detail below, because broker-dealers that provide discretionary investment advice are currently already required to register as investment advisers, the relevant subset of advisory services subject to differing standards arguably is limited to non-discretionary services. In this regard, we note that only 8% ($4.6 trillion out of $54.8 trillion) of regulatory assets under management (RAUM) reported by all SEC-registered investment advisers are advised on a non-discretionary basis.[18]

Application of Different Rules to Similar Activities [Item 3]

Item 3 asks for a comparison of the regulatory regimes applicable to broker-dealers and investment advisers engaged in similar activities. In assessing the regimes, the Commission should keep in mind the following information from the IARD as of April 12, 2013:

- 477 (5%) of SEC-registered investment advisers are also registered as broker-dealers. Thus, such broker-dealers already are subject to the fiduciary standard when they engage in investment advisory activities and presumably have incorporated the standard into their business model.

- Although the vast majority of investment advisers (95%) are compensated based on a percentage of the client's assets under management, 5% report that they are compensated through commissions. Therefore, the investment adviser fiduciary standard already accommodates commissions as a form of compensation.

The IARD data thus indicate that some broker-dealers already apply the fiduciary standard to their business models, and that the standard is flexible enough to accommodate investment advisers that receive some of their compensation in the form of commissions.

The following generally describes the regulatory regime and fiduciary obligations applicable to investment advisers and broker-dealers providing investment advice. For more detail on the respective regulatory regimes, see Appendix A to this letter.

[17] The "portfolio management of pooled investment vehicles (other than investment companies)" and "educational seminars/workshops" categories were added to the form in 2012; therefore, these figures cannot be compared to prior years.

[18] We note that the non-discretionary advice provided by advisers and brokers may differ in significant respects. The non-discretionary assets reported by advisers generally are those they for which they "provide continuous and regular supervisory or management services." The instructions to Form ADV Part 1 permit advisers to include non-discretionary assets in their RAUM if they "have ongoing responsibility to select or make recommendations, based upon the needs of the client, as to specific securities or other investments the account may purchase or sell, and, if such recommendations are accepted by the client, [they] are responsible for arranging or effecting the purchase or sale." Form ADV Part 1A, instructions for Item 5F. This type of ongoing non-discretionary advice differs from the periodic or episodic non-discretionary advice offered by many brokers.

Investment Advisers

Investment advisers are subject to a comprehensive regulatory regime in providing advice to all of their clients, which has as its foundation the fiduciary standard under the Advisers Act. As discussed above, serving as a fiduciary means acting in the best interests of clients and providing clients with the highest duty of loyalty and care. In addition, fiduciary duty means that, in the course of providing advice to clients, including non-discretionary advice to retail clients, advisers must disclose all material information to their clients, 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.

Moreover, as fiduciaries, investment advisers must treat their clients fairly and not favor themselves or favor one client over another, especially if the adviser would somehow benefit. For example, investment advisers that enter into performance fee arrangements with some, but not all, of their clients must establish policies and procedures to ensure that they do not reserve advantageous investment opportunities to such clients to the disadvantage of clients whose fees are based only on a percentage of assets under management (generally referred to as "side-by-side management"). In addition, under the fiduciary standard, whenever the interests of an adviser differ from those of its clients, the adviser must explain the conflict to the client, and act to mitigate or eliminate the conflict.

Investment advisers are also subject to numerous specific SEC rules and interpretations, most of which are derived from the overarching fiduciary duty owed to their clients. For example, investment advisers must provide extensive disclosures to their clients on Form ADV, which requires information about an adviser's business, client base, industry affiliations, services, and compensation, and how it identifies and addresses potential conflicts of interest. Advisers are also subject to restrictions on advertising, entering into principal trades and agency cross transactions, holding client assets, contributing to political candidates, choosing broker-dealers, receiving soft dollar benefits, and personal investing.

Furthermore, advisers must establish an internal compliance program that addresses the adviser's performance of its fiduciary and substantive obligations under the Advisers Act. Each adviser must also adopt and implement written policies and procedures reasonably designed to prevent the adviser and its personnel from violating the Advisers Act, and must review the effectiveness of the policies and procedures at least annually.[19] In addition, advisers must adopt written codes of ethics, which must set forth standards of conduct expected of advisory personnel to reflect advisers' fiduciary obligations and to address conflicts that arise from personal trading by advisory personnel.

Broker-Dealers

The fiduciary standard currently applies to certain activities of broker-dealers as well. If a broker-dealer provides discretionary asset management to a client for a fee, then the Advisers

[19] For more information about the duties and obligations of investment advisers, *see* 913 Study at 14-46.

Act and its accompanying fiduciary duty apply with respect to that account.[20] Broker-dealers also may be subject to state law fiduciary duty under certain circumstances, depending on state law and the relationship between the broker-dealer and its client.[21] Furthermore, the SEC staff has taken the position that brokers providing discretionary asset management based on commissions and brokers that charge a separate fee for advice also are subject to the Advisers Act and its fiduciary standard.[22] On the other hand, a broker-dealer whose performance of advisory services is "solely incidental" to the conduct of its business as a broker-dealer and who receives no "special compensation" for such services is excluded from coverage under the Advisers Act and its overarching fiduciary duty.

Thus, the services for which broker-dealers and investment advisers currently are subject to different standards of care are primarily non-discretionary investment advisory services, such as making recommendations about securities to brokerage customers.[23] The existing standard of care for broker-dealers that engage in such activities is that specified in FINRA Rule 2111, which requires that a broker-dealer ensure that the advice is "suitable" to the client.[24] In addition, FINRA Rule 2010 requires broker-dealers when dealing with customers to "observe high standards of commercial honor and just and equitable principles of trade."[25] The use of

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[20] These firms generally are dually registered as both broker-dealers and investment advisers.

[21] In some states, courts have found a broker-dealer to owe a fiduciary duty to a customer in limited circumstances in which the broker-dealer has discretion over an account or because of a special relationship of trust and confidence has *de facto* discretion. *See, e.g.*, *Hecht v. Harris*, 430 F.2d 1202 (9th Cir. 1970) (holding that despite a non-discretionary account, a broker-dealer owed fiduciary duties to a 77-year-old customer who was unable to understand confirmation slips); *Kravitz v. Pressman, Frohlich & Frost*, 447 F. Supp. 203 (D. Mass. 1978) (holding that a broker-dealer owed fiduciary duties in a non-discretionary account where the customer was clearly unable to understand confirmation slips and completely relied on decisions of the broker, who the customer was dating at the time). Unlike investment advisers under the Adviser Act, however, broker-dealers are not considered fiduciaries by operation of law.

[22] Interpretive Rule under the Advisers Act Affecting Broker-Dealers, Investment Advisers Act Rel. No. IA-2652 (Sept. 24, 2007). Although the proposed interpretations have not been finalized, they are the most recently expressed views of the Commission on this subject, and we understand that they continue to represent the Commission's interpretation.

[23] *See* Letter from Christopher Gilkerson, Senior Vice President, Deputy General Counsel, Charles Schwab & Co., Inc. to Elizabeth M. Murphy, Secretary, SEC, re: Release No. IA-3058 Study Regarding Obligations of Brokers, Dealers, and Investment Advisers, at 7-8 (Aug. 30, 2010).

[24] FINRA Rule 2111 provides, with respect to non-institutional customers: "(a) A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation."

[25] FINRA Rule 2010 prohibits broker-dealers from: (1) filing misleading information about membership or registration; (2) trading ahead of a customer limit order; (3) failing to abide by FINRA's front-running policy; (4) engaging in certain purchases or sales in initial public offerings; and (5) failing to register its employees. *See* FINRA Rule 1122 Filing of Misleading Information as to Membership or Registration; IM-1000-3 Failure to

such terminology itself demonstrates that the standards to which broker-dealers are held are essentially standards of fair treatment reflecting a commercial arrangement rather than a relationship of trust and confidence, as contemplated by the Advisers Act.

Principal Transactions [Item 7]

Item 7 asks for data describing the extent to which broker-dealers and investment advisers engage in principal trading with retail customers. Part 1 of Form ADV addresses principal trading in Item 8A(1). In response to this Item, only 8% of all SEC-registered advisers as of April 12, 2013 indicated that the adviser or a related person buys securities for itself from advisory clients or sells securities it owns to advisory clients. 13.7% of the advisers that engage in principal trading are dually registered as broker-dealers, and 25% of dually registered investment advisers engage in principal trading. Broker-dealers, by contrast, make extensive use of principal trading, especially with respect to fixed income securities.

Client Complaints [Item 9]

In Item 9, the Commission has asked for data and other information related to the ability of retail customers to bring claims against their financial professionals under each regulatory regime. IAA members report that such complaints are relatively unusual, primarily because their firm applies the fiduciary standard to their dealings with clients, and "always put the clients' interests first." For example, in the case of trading errors, an area for which there is no specific rule, under the fiduciary standard applied by investment advisers, clients routinely are made whole for any losses that result from the adviser's trading errors.

The handling of client complaints is a standard provision of investment advisers' compliance policies and procedures, which typically require that such complaints be brought to the attention of senior management immediately. Our members indicate that client complaints are considered a high priority and are generally resolved in a fair and equitable manner that serves to ensure the relationship with the client is preserved, irrespective of difference of opinion or cost. Most disputes are resolved internally, in light of the adviser's ongoing fiduciary duty to its client. This method of dispute resolution results in relatively few formal litigated cases.

If the client and the adviser cannot work out a dispute, the client has a number of options. Advisory clients have a private right of action under Advisers Act Section 215 to void an investment adviser's contract and obtain restitution of fees paid.[26] In addition, a client may privately enforce claims against an investment adviser under the Exchange Act. For example, if the client has a fraud claim in connection with the purchase or sale of a security, the client may bring an action under Exchange Act Section 10(b) and Exchange Act Rule 10b-5. Although the courts have not recognized a private right of action under the Advisers Act other than under Section 215, investment advisers' clients can bring common law fiduciary cases under state

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Register Personnel; IM-2110-2 Trading Ahead of Customer Limit Order; IM-2110-3 Front Running Policy; FINRA Rule 5130 Restrictions on the Purchase and Sale of Initial Equity Public Offerings.

[26] *Transamerica Mortgage Advisors, Inc.*, 444 U.S. 11, 17 (1979).

law.[27] A client could make a state common law claim that the adviser has violated its fiduciary duty, was negligent, or committed fraud. In addition to these claims, a number of states have adopted statutes regulating investment advisers that provide private rights of action for fraud.[28]

By contrast, customer complaints against broker-dealers are typically subject to mandatory arbitration in a forum operated by FINRA. Interestingly, most complaints against brokers in arbitration involve claims of breach of fiduciary duty by the broker.[29] Thus, brokers are presumably already addressing this litigation risk in their business practices and compliance programs, including the risk that customers expect their financial advisors to be acting in their best interests.

Conflicts of Interest [Item 10]

The Commission in Item 10 asks for information about investment adviser conflicts of interest. As fiduciaries, investment advisers must assess what conflicts they have, in effect compiling an inventory of such conflicts. They then must determine how to address conflicts by avoiding or mitigating them through instituting policies and procedures to ensure that the firm places the best interests of its clients first. The adviser must also provide full and fair disclosure of the nature of its practices and the conflicts they present and how the adviser addresses them. Advisers must provide a detailed, narrative explanation of conflicts identified by the SEC in Form ADV Part 2. In addition, as fiduciaries, investment advisers must disclose any other conflicts in Part 2 or by other means. In addition, Part 1 of Form ADV requires advisers to provide additional information about potential conflicts.

The fiduciary standard in the context of conflicts of interest requires more than merely disclosing potential conflicts. The adviser must be aware of the potential for conflicts, develop policies and procedures to avoid or mitigate them, disclose those policies, and monitor the effectiveness of the policies. A good example of how the fiduciary duty works in practice arises in the area of compensation. If investment advisers receive payment from others for recommending certain types of products, the advisers must tell clients about the compensation and how the compensation may potentially affect or influence the investment advice that is given. In addition to disclosing this information to clients, investment advisers must act to recommend securities that are in the best interests of the clients regardless of the additional compensation they may receive. Investment advisers also must make disclosures regarding conflicts created by their compensation arrangements. For example, advisers paid by commission are required to disclose that commission-based compensation may motivate them to

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[27] *See* 913 Study at 44-45. Some state court decisions rely on the federal fiduciary standard in addition to state law. For example, in *State of New Mexico v. Colonial Penn Ins. Co.,* 812 P.2d 777 (N.M. 1991), the Supreme Court of New Mexico relied in part on the federal fiduciary duty owed by investment advisers in reversing the trial judge's grant of summary judgment in favor of the adviser.

[28] *See* 913 Study at 45.

[29] In 2012, 2,216 out of the 4299 claims involved some claim of breach of fiduciary duty. *See* FINRA Dispute Resolution Statistics at http://www.finra.org/ArbitrationAndMediation/FINRADisputeResolution/AdditionalResources/Statistics/index.htm.

trade more frequently or to recommend trades because they would receive more compensation. They must also periodically monitor the application of and the continued effectiveness of their policies to ensure that conflicts do not result in actions contrary to the best interests of clients.[30]

Cost Data Concerning Mandatory Disclosures [Item 11]

The Commission requests data regarding the cost of providing mandatory disclosures to retail customers. As discussed above, investment advisers are required to provide extensive disclosures about their businesses, services, practices, and material conflicts of interest. Form ADV Part 2A, which is available publicly, specifically requires disclosures regarding a firm's advisory business, fees and other compensation, management of conflicts arising from "side-by-side management," types of clients, methods of analysis, investment strategies, risk of loss, conflicts of interest, disciplinary information, other financial industry activities and affiliations, code of ethics, participation or interest in client transactions and personal trading, brokerage practices, review of accounts, client referrals and other compensation for business, custody, investment discretion, proxy voting, and any material concerns about the adviser's financial condition. These documents can run from 10 pages to more than 50 pages in length depending on the firm's breadth of services, investment strategies, and types of clients, as well as the firm's structure and affiliations. In addition, Form ADV Part 2B requires specific disclosures regarding an adviser's supervised persons, including information regarding educational and business background, disciplinary history, other business activities, additional compensation, and supervision. The effort required to provide Part 2B disclosures depends significantly on the number of employees at each firm subject to the requirement.

We understand from our members that the initial drafting of these disclosure documents takes substantial time and effort. Once a firm has initially drafted its disclosure documents, ongoing costs result from re-inventorying the firm's practices, services, and conflicts to ensure that any changes over the past year are reflected in annual amendments to the Form and that any material changes are incorporated promptly into disclosures provided to clients. The results of a recent survey of investment advisers[31] indicates that, for 2012, 46.9% of firms reported spending less than $10,000 on Form ADV Part 2-related compliance; 19.2% spent $10,000-$25,000; 9.8% reported spending $25,000-$50,000; and a relatively modest number of firms spent more than $50,000.

Of the advisers reporting serving individuals as a "primary service" that provided an estimate of costs, 67.7% spent less than $10,000 in 2012 on Form ADV Part 2 compliance. Another 19.6% spent $10,000-$25,000. The firms serving individuals that spent the most on

[30] An adviser must review the adequacy and effectiveness of its policies at least annually. *See* Rule 206(4)-7(b). While the rule only requires an annual review, in practice, an adviser should monitor its policies and procedures on an ongoing basis. *See, e.g.,* Carlo V. di Florio, Director, Office of Compliance Inspections and Examinations, SEC, *Conflicts of Interest and Risk Governance*, Address Before the National Society of Compliance Professionals (Oct. 22, 2012) available at http://www.sec.gov/news/speech/2012/spch103112cvd.htm ("Under the securities laws, registrants are expected to have effective written policies and procedures to prevent violations of the securities laws, and to periodically review the adequacy and effectiveness of those policies and procedures.").

[31] 2013 IAA-ACA Compliance Group-Old Mutual Asset Management Compliance Testing Survey.

Form ADV Part 2 compliance (more than $100,000) were quite large either in terms of assets under management or number of employees or both.

Retail Client Confusion [Item 14]

Under the current regulatory regime, retail customers seeking non-discretionary investment advice may choose a broker-dealer or an investment adviser, and may not know which type of financial professional they have hired. This is especially true if they are referred to a specific person who has provided such advice to a friend, relative, or co-worker. Furthermore, even if the retail customer knows that he or she has hired a broker-dealer or an investment adviser, he or she is not likely to understand that there are different standards of care applicable to each.[32]

Some broker-dealers have exacerbated this confusion by calling their registered representatives "financial consultants," "financial advisors," or "account executives." This fact was noted in a study that the SEC commissioned from RAND Corporation in 2008, which found that "broker-dealers have begun to drift subtly into a domain of activities that (at least under the regulatory regime) have historically been the province of investment advisers."[33] Based on interviews conducted with investors, the report found investor confusion resulting from the manner in which broker-dealers marketed themselves:

> *as much of the recent marketing by broker-dealers focuses on the ongoing relationship between the broker and the investor and as brokers have adopted such titles as "financial advisor" and "financial manager."*[34]

Broker-dealers have been aggressively marketing themselves as "advisors," "wealth managers," and "financial consultants" upon whom customers can rely and trust. The resulting confusion has created a mismatch between client expectations and reality, with clients expecting that their brokers are acting in the clients' best interests. We maintain that the Commission should act to ensure that investors who place their trust in broker-dealers for investment advice are protected by the higher standard of care required of fiduciaries.

III. Uniform Fiduciary Standard – Assumptions

In Section III of the Request, the Commission articulates a number of assumptions underlying its consideration of the application of a uniform fiduciary standard to broker-dealers

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[32] *See* RAND Report at 31-32.

[33] *Id.* at 14; *see also, Industry Perspectives on the Obama Administration's Financial Regulatory Reform Proposals, Hearing Before the H. Comm. on Fin. Servs*., 111th Cong. at 16-17 (July 17, 2009) (statement of Paul Schott Stevens, President and CEO, Investment Company Institute) (noting that "over the last decade, brokers have significantly shifted their business model to include providing investment advice and charging fees based on assets under management, rather than commissions for each transaction. This model previously had been used solely by investment advisers.").

[34] RAND Report at 19.

and investment advisers. Taken as a whole, the stated assumptions appear to indicate that the Commission intends to add a disclosure component to the existing broker-dealer regime and declare that the combination creates a fiduciary standard. We would strongly oppose this weakening of the fiduciary standard. Our concerns with respect to the assumptions are as follows:

Scope of Fiduciary Duty [Assumption 3]

The Request states that commenters should assume that any action that the Commission takes would apply to all SEC-registered broker-dealers and SEC-registered investment advisers. We agree, but only to the extent that the SEC simply codifies the existing overarching fiduciary principle in the Advisers Act in a parallel rulemaking as discussed in the 913 Study and as contemplated by the Dodd-Frank Act. The Commission's goal should be to extend the existing Advisers Act standard to brokers such that it is no less stringent than the existing standard for advisers.

Accommodation of Different Business Models [Assumption 4]

The Request correctly states that the uniform fiduciary standard would be designed to accommodate different business models and fee structures. Flexibility is a key feature of the Advisers Act fiduciary standard. The fiduciary duty generally does not prohibit a particular type of activity or compensation arrangement, but requires disclosure and mitigation of potential conflicts of interest designed to ensure that the activity is in the best interests of the client. Indeed, investment advisers use a variety of compensation structures, including commissions.[35] The existing fiduciary standard accommodates all of them and no modification of the standard is necessary.

Continuing Duty of Care/Limited Services [Assumption 5]

The Commission indicates that it does not assume that a broker-dealer or investment adviser would have a continuing duty of care or loyalty after providing advice or be required to provide services beyond those on which the parties have agreed, an assumption that follows Section 913 of the Dodd-Frank Act. We recognize that broker-dealers and investment advisers provide a range of types of advice and that not all advice is ongoing and requires monitoring. As noted above, the fiduciary standard is flexible and can accommodate the full range of types of advice.

We agree with the Commission's statement that the nature and scope of the duty rests on the "totality of the circumstances of the relationship and course of dealing" and is not limited to the terms of the contract. The terms of the fiduciary's agreement with its client purporting to limit its responsibilities would not control, for example, if contrary to disclaimers in the contract, statements or actions by firm personnel or the context of the relationship led a client to believe that the firm would be monitoring the client's investments on an ongoing basis. In addition, we

[35] *See supra* p. 8, noting that about 5% of investment advisers charge commissions.

note that client advisory agreements cannot be used to limit fiduciary duties that would otherwise apply to the services offered.[36]

Further, while we agree that the Dodd-Frank Act contemplates a broker's ability to engage in one-time recommendations for clients without the obligation to monitor the client's circumstances and account on an ongoing basis, we believe that the language "after providing him or her personalized investment advice" should not be read to permit "hat-switching." In other words, a broker should not be able to make a recommendation as a fiduciary and then switch to a non-fiduciary hat to execute that same recommendation. The "advice" referenced in the statute should incorporate the entire interaction with respect to that recommendation. The client confusion that Section 913 was designed to address would only be exacerbated if the broker-dealer were able to switch back and forth between fiduciary and non-fiduciary status with respect to its investment advice.

Limited Range of Products [Assumption 6]

The Release's sixth assumption restates the language of Section 913 that the offering or recommending of only proprietary or a limited range of products would not, in and of itself, violate the fiduciary standard. The Commission should also recognize, however, that the fiduciary duty requires that any actions taken must be in the best interests of the client; therefore, an analysis of whether the fiduciary's actions are appropriate does not end with this provision. For example, although the fiduciary may offer advice with respect to only a limited range of investments, it may not recommend an investment that would not be in the best interests of the client. Therefore, if none of the investments in the limited range were appropriate for the client, the fiduciary could not recommend them and should advise the client of that fact.

Sections 206(3) and 206(4) [Assumption 7]

According to the seventh stated assumption, broker-dealers would not be subject to sections 206(3) and 206(4) of the Advisers Act. We recognize that the "no less stringent" language in Section 913 references only sections 206(1) and (2) of the Advisers Act. Even if sections 206(3) and (4) do not specifically apply, however, many of the principles addressed by the specific requirements included in these sections are embedded in the fiduciary duty. Thus, brokers would be obligated to analyze their activities in light of these principles and implement policies and procedures to avoid breach of their fiduciary duty.

Principal trading presents a fundamental conflict of interest "and a substantial risk that the proprietary interests of the adviser will prevail over those of its clients."[37] The 913 Study had recommended that the Commission issue guidance or commence rulemaking governing how

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[36] *See* SEC Division of Investment Management, *Regulation of Investment Advisers*, at nn. 274-275 and accompanying text (Mar. 2013) (Adviser Regulation).

[37] Temporary Rule Regarding Principal Trades with Certain Advisory Clients, Investment Advisers Act Rel. No. IA-2653 (Nov. 30, 2007) at 14.

brokers should comply with their fiduciary duties with respect to principal trading.[38] The Request, however, states only that commenters should assume that brokers must disclose their material conflicts of interest arising from principal trades with retail clients.[39] We strongly disagree that disclosure alone is sufficient to address this fundamental conflict. Regardless of whether the specific prophylactic provisions of section 206(3) apply, as fiduciaries, broker-dealers should be required to ensure that a principal trade is fair and in the best interests of the client.[40]

Similar fiduciary principles underlie the rules related to advertising, custody, pay to play,[41] and proxy voting. Thus, in advertising and communications with clients, advisers must take care to,[42] for example, (1) disclose all material facts that "a reasonable investor ought to know in order to make informed decision;" (2) ensure that communications are "materially complete so as to provide a fair and balanced picture;" (3) avoid advertisements or other communications "that contain only a partial truth, leaving an exaggerated, unwarranted, or other potentially misleading impression;" or (4) avoid cherry-picking recommendations, performance, or other claims.[43]

With respect to the proxy voting rule, the Commission staff has stated that "an adviser, as a fiduciary, owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting. The duty of care requires an adviser

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[38] 913 Study at 120. We understand that application of the specific prophylactic provisions of section 206(3) of the Advisers Act could present serious challenges for brokers. We support the Study's recommendation that, as part of the fiduciary rulemaking, the Commission examine its approach to principal trading rules for both brokers and advisers. Any modification of the current section 206(3) requirements should be designed to ensure that principal trades are in the best interests of clients and conducted transparently and fairly.

[39] This issue is also raised in Assumption 4 of the Request.

[40] *See* Adviser Regulation, *supra* note 36 at 30. *See also id*. at n.157 (citing *Rocky Mountain Financial Planning, Inc*., SEC Staff No-Action Letter (Feb. 24, 1983)) ("While section 206(3) of the Investment Advisers Act of 1940 requires disclosure of such interest and the client's consent to enter into the transaction with knowledge of such interest, the adviser's fiduciary duties are not discharged merely by such disclosure and consent. The adviser must have a reasonable belief that the entry of the client into the transaction is in the client's interest."); *id.* at n. 161 ("Merely following the procedures set forth in [Investment Company Act] rule 17a-7 may not satisfy an adviser's fiduciary obligation to clients [with respect to cross-trades]. The staff has explained that it must be in the best interest of both clients to enter into a cross-trade and thus, for example, an adviser should not cause a client to enter into a cross-trade if it could obtain a better price in the markets.").

[41] "Investment advisers that seek to influence the award of advisory contracts by public pension plans, by making political contributions to, or soliciting them for, those officials who are in a position to influence the awards, compromise their fiduciary obligations to the public pension plans they advise and defraud prospective clients." *See* Political Contributions by Certain Investment Advisers, Rel. No. IA-3043, at 17 (July 1, 2010).

[42] *See Capital Gains*, 375 U.S. at 194 ("Courts have imposed on a fiduciary 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.").

[43] *See* Lorna A. Schnase, *Investment Adviser's Fiduciary Duty*, at n.71 and accompanying text (Aug. 1, 2010) (available at http://www.40actlawyer.com/Articles/Link3-Adviser-Fiduciary-Duty-Paper.pdf).

with proxy voting authority to monitor corporate events and to vote the proxies. To satisfy its duty of loyalty, the adviser must cast the proxy votes in a manner consistent with the best interests of its client and must not subordinate client interests to its own."[44] These principles apply separate and apart from the prophylactic rule.

Existing Broker-Dealer Law and Guidance [Assumption 8]

In its eighth assumption, the Request assumes that existing applicable law and guidance governing broker-dealers, including SRO rules and guidance, would continue to apply to broker-dealers. Broker-dealer rules are designed to promote business conduct that, among other things, protects investors from abusive practices, including practices that are not necessarily fraudulent. They are required to deal fairly with their customers under the anti-fraud provisions of the federal securities laws.[45] In addition, broker-dealers are required under SRO rules to deal fairly with customers and to "observe high standards of commercial honor and just and equitable principles of trade."[46] Among other things, this obligation includes having a reasonable basis for recommendations in light of a customer's financial situation to the extent known to the broker (suitability).[47]

We agree that broker-dealers should be subject to broker-dealer law and guidance with respect to their traditional broker-dealer activities, but the fiduciary standard should govern their investment advisory activities with respect to retail clients. Thus, existing law applicable to such activities should be modified to ensure it reflects brokers' fiduciary duties to their clients. At a minimum, the suitability rules should be revised to reflect a "best interest" standard.

Assumptions Related to the Duties of Loyalty and Care

The Request also includes in its discussion of a possible uniform fiduciary standard certain assumptions concerning two aspects of the fiduciary standard: the duty of loyalty and the duty of care. We are concerned that the way that the Request is couched may reflect an incomplete understanding of the scope of the fiduciary standard. The Request suggests that the requirements of these two duties can be satisfied almost entirely by disclosing conflicts of interest, conforming to a suitability standard, and receiving only reasonable compensation.[48] This approach suggests that the Commission is inclined to simply take existing broker-dealer

[44] 913 Study at 39.

[45] *Id*. at 51.

[46] FINRA Rule 2010.

[47] 913 Study at 52.

[48] The one exception to this emphasis on disclosure is the mention of prohibition of certain sales contests.

rules[49] and impose a disclosure overlay.[50] Such an approach would be woefully inadequate.[51] The existing fiduciary standard applicable to investment advisers is far more protective of clients than this limited set of potential rules.

Among the specific obligations that flow from an adviser's fiduciary duty, in addition to the duty to make full and fair disclosure to clients of all material facts, particularly conflicts of interest, are: [52]

- the duty to place the clients' interests first;
- the duty to have an adequate, reasonable basis for its investment advice;
- the duty to inform itself about clients' situations and circumstances;
- the duty to use only those strategies for which the adviser is reasonably competent;
- the duty to follow client instructions, guidelines and governing documents;
- the duty to perform due diligence on sub-advisers and other third parties;
- the duty to seek best execution for clients' securities transactions where the adviser directs such transactions;

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[49] In fact, with respect to the duty of care, the Request lists only existing broker-dealer business conduct rules.

[50] This inclination is even reflected in the Request's terminology. For example, the Request's duty of care discussion speaks in terms of suitability and product-specific requirements rather than the fiduciary terminology of the "prudent person" duty of care.

[51] *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) available at http://www.sec.gov/news/speech/speecharchive/1999/spch279.htm ("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.").

[52] *See* Amendments to Form ADV, Investment Advisers Act Rel. No. IA-2106 (July 28, 2010); Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients, Investment Advisers Act Rel. No. IA-1406, n. 3 (Mar. 16, 1994) (noting duty of full disclosure of conflicts of interest, duty of loyalty, duty of best execution, and duty of care and citing various sources); Applicability of Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Rel. No. IA-1092, (Oct. 8, 1987) (1092 Release) (discussing fiduciary duties). *See also* IAA Standards of Practice, available at https://www.investmentadviser.org/eweb/dynamicpage.aspx?webcode=StandardsPractice.

- the duty to render advice that is suitable to clients' needs, objectives, and financial circumstances;
- the duty to vote proxies in the best interests of clients;
- the duty to allocate investment opportunities fairly among clients;
- the duty not to subrogate clients' interests to its own;
- the duty not to use client assets for itself; and
- the duty to maintain client confidentiality.

We also note, however, that the fiduciary duty standard is overarching, and, because it is principles-based, cannot be completely captured in or reduced to a "checklist."

By suggesting that the duties of loyalty and care can be satisfied without including these essential responsibilities as well as the general prudent person duty of care and the responsibility to put the clients' interests ahead of the adviser's own interests, the Request implies that the Commission may be considering inappropriately limiting the scope of the fiduciary duty and applying a narrow version of the Advisers Act fiduciary standard. This approach would not further the directive of Section 913 to provide a standard of conduct no less stringent than the standard applicable to investment advisers. We urge the Commission to give full weight to the existing fiduciary standard applicable to investment advisers in its rulemaking under Section 913.

Application of Prior Guidance

The Request indicates that certain existing guidance and precedents under the Advisers Act fiduciary standard would apply to broker-dealers, but curiously identifies only two areas where commenters should assume these precedents would apply: allocation of investment opportunities and the aggregation of orders. We concur that these precedents should continue to apply to investment advisers and be extended to broker-dealers to the extent that they are not already applied. However, as recommended by the SEC staff in the 913 Study, *all* precedent and guidance regarding the fiduciary standard under Advisers Act sections 206(1) and 206(2) should continue to apply to advisers and be extended to broker-dealers.

Critically, guidance and precedent regarding conflicts of interest and failures to disclose such conflicts must apply to broker-dealers.[53] There is no reason why case law or guidance describing an adviser's duties with respect to conflicts should not apply to brokers providing advice. In addition, precedent involving the duty of care should apply to brokers as well as advisers.[54] Similarly, precedent regarding use of client assets for the adviser's own benefit

[53] *See, e.g., Capital Gains*, *supra* note 9; 913 Study at 22-24 and cases cited therein.

[54] *See, e.g., In the Matter of Baskin Planning Consultants, Ltd.,* Inv. Adv. Rel. No. 1297 (Dec. 19, 1991); *In the Matter of Alfred C. Rizzo,* Inv. Adv. Rel. No. 987 (Jan. 11, 1984).

should be extended to brokers providing advice.[55] All the existing precedent would, of course, only apply to brokers' advice where relevant based on the services they provide, as is the case for advisers. For example, guidance related to voting client proxies is relevant only where the adviser or broker is responsible for voting client proxies.

The Request does not explain its failure to incorporate the 913 Study staff recommendation. As we have previously demonstrated, the few cases cited by broker-dealer groups as potential cause for concern do not, upon analysis, pose any obstacles to application of Advisers Act fiduciary duty precedents to brokers providing personalized advice to clients.[56] Indeed, if the Commission does not extend precedent and guidance related to the Advisers Act fiduciary duty to brokers giving advice, the rulemaking would not satisfy the Dodd-Frank Act mandate for a uniform fiduciary standard no less stringent than the Advisers Act standard.

Alternative Approaches and Changes in the Marketplace

In addition to requesting comment concerning the application of the uniform fiduciary standard to broker-dealers, the Commission asks commenters to consider a range of alternative approaches. We maintain that the only appropriate course of action is to apply the Advisers Act fiduciary standard to broker-dealers providing investment advice. This approach would provide enhanced protections for clients over the current regime based on suitability. If subjecting broker-dealers to the fiduciary standard might require a change in certain aspects of some of their business activities, it would benefit clients by conforming to clients' expectations and providing a higher level of protection. We also submit that this higher level of protection should benefit all clients, and not just "retail" clients.

Investment advisers have been subject to this standard for decades, and there would be no justification for changing the fiduciary standard with respect to advisers. If the Commission is considering applying a different version of the fiduciary standard, such as one that does not apply existing precedent and guidance under the standard to broker-dealers, this weakened standard should only apply to broker-dealers. The standard applicable to investment advisers should not change; otherwise, advisory clients would be disadvantaged by a less protective regime,[57] and the change would violate the Dodd-Frank Act's direction that any fiduciary standard be no less stringent than the Advisers Act fiduciary standard. We also maintain that broker-dealers subject to the weakened standard should not be able to claim fiduciary status.

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[55] *See, e.g.,* Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Rel. No. 34-54165 at 3 (July 18, 2006); *In the Matter of Fidelity Management & Research Company and FMR Co., Inc.,* Rel. No. IA-2713 (Mar. 5, 2008).

[56] *See* March 2012 Joint Letter, *supra* note 3, at 3-5.

[57] Further, to the extent that the Commission's rulemaking changes the existing fiduciary standard for advisers, retail clients would receive a lower level of protection than institutional clients. In addition, advisers would have to comply with two sets of standards with respect to the same activities for different groups of clients, with no corresponding investor protection benefit.

IV. Further Regulatory Harmonization

The final section of the Request indicates that the Commission may consider harmonizing other regulatory requirements applicable to broker-dealers and investment advisers in addition to their standard of conduct, and lists certain potential areas for harmonization. As an initial matter, we question why the Commission is considering harmonization of the broader regulatory regimes of brokers and advisers before it implements the fiduciary standard for broker-dealers and has the opportunity to assess how fiduciary duty affects or interacts with current broker-dealer rules. This higher standard would overlay all specific rules governing brokers' provision of investment advice to their retail customers and may necessitate adjustments to current regulations.

We also are concerned that the Request's discussion does not systematically compare the two regulatory regimes to determine which regulatory framework is more protective of clients as to various activities (*e.g.*, portfolio management vs. non-discretionary recommendations vs. market-making activities, *etc.*), but instead appears to favor imposing the broker-dealer regulatory regime on investment advisers. The Request extensively discusses harmonization in the context of applying broker-dealer rules designed for a wide range of activities to investment advisers, while leaving it to commenters to discuss whether to apply investment adviser rules – which were designed specifically for the provision of investment advice – to broker-dealers giving advice.[58] Indeed, in the preceding fiduciary section, the Request specifically states that Advisers Act rules under sections 206(3) and (4) would not apply to brokers, and uses broker-dealer nomenclature and constructs, including the use of the term "customer" in referring to investment advisory clients and business conduct rules as a stand-in for the duty of care, throughout the Request.

A full consideration of harmonization from an adviser perspective would include, for example, a discussion of how brokers and advisers can assure that their actions are prudent and in the best interests of their clients. Given that investment advisers' activities are already appropriately covered by the Advisers Act fiduciary standard and rules designed for such activities, and that these activities differ significantly from those of broker-dealers, we would oppose the imposition of the broker-dealer regulatory regime on investment advisers.

The current regulatory landscape reflects the different purposes of the Advisers Act and the Exchange Act. The purpose of the Advisers Act is to address the provision of investment advice. The Exchange Act and accompanying FINRA rules, on the other hand, are focused on a much broader range of activities[59] for which more detailed rules are appropriate, with a subset of provisions related to specific aspects of investment recommendations, which have been supplemented as some broker-dealers have engaged in more in-depth advisory activities such as investment and financial planning.

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[58] Request at n. 39.

[59] Broker-dealers offer a wide range of services other than investment advice, including selling securities, mutual fund shares and variable annuities; selling interests in limited offerings or private placements; margin lending; securities lending; taking custody of client funds or securities; executing trades; acting as a market maker, dealer syndicator or underwriter; or engaging in stock exchange floor activities.

Broker-dealer rules generally are designed to address "selling" activity as opposed to "advice" or "investment" activity, and are often characterized as "check-the-box" requirements, in that they require adherence to a prescribed set of specific rote procedures rather than the big picture consideration of guiding principles that applies under the Advisers Act. The Advisers Act regulatory regime is specifically geared toward investment advisory activities and provides a flexible framework that permits the broad diversity of advisory firms to tailor their compliance programs to fit their specific activities.[60] Thus, the current regulatory Advisers Act framework is already scalable by virtue of its flexibility.

Arguments by some that certain broker-dealer requirements are more protective of retail investors appear to be based on misunderstandings about investment adviser regulation or are not based on apples-to-apples comparisons of the same activities. For example, many of the broker-dealer rules are geared to sales of products rather than portfolio management activities. We submit that regulation should address these dissimilar activities differently. Moreover, misconceptions about adviser regulation appear to be based on a lack of appreciation of how fiduciary principles pervade all investment adviser activities, and the responsibilities placed on advisers under the compliance program rule. Thus, the Request contemplates imposing business conduct rules on advisers but fails to recognize the extent to which advisers are already covered by both the fiduciary standard and compliance program rule in these areas. Appendix A, which contains a detailed comparison of the various regulations applicable to broker-dealers and investment advisers when providing investment advice, illustrates the fallacy of these misconceptions.

For example, advertisements are regulated under each regime, but in different respects. Both investment advisers and broker-dealers are subject to similar anti-fraud-type principles and supervisory liability for advertisements. Substantially equivalent requirements apply to internal approval of advertising: FINRA requires broker-dealers to obtain principal approval of advertisements (and to file certain marketing materials with FINRA); the Advisers Act compliance program rule provides a framework for investment advisers to establish policies and procedures to ensure that advertisements are not misleading, which inherently involves internal approval processes and training. There is no evidence that the flexible compliance program rule approach for policies, procedures, training, and supervision is less effective than the costly command-and-control approach set out in detailed FINRA rules.[61] Further, much of the FINRA

[60] *See, e.g.*, Investment Adviser Codes of Ethics, Investment Advisers Act Rel. No. IA-2256 (July 9, 2004) ("proposal left advisers with substantial flexibility to design individualized codes that would best fit the structure, size and nature of their advisory businesses"); Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Rel. No. IA-2204 (Dec. 17, 2003) ("Commenters agreed with our assessment that funds and advisers are too varied in their operations for the rules to impose of a single set of universally applicable required elements"); Proxy Voting by Investment Advisers, Investment Advisers Act Rel. No. IA-2106 (Jan. 31, 2003) ("Investment advisers registered with us are so varied that a 'one-size-fits-all' approach is unworkable").

[61] In addition to the internal costs of complying with very specific procedural requirements, brokers must pay FINRA fees for review of marketing material. For regular filings, FINRA charges $125 for the first ten pages of material; $10 for each additional page; $125 for the first ten minutes of each video and audio item; and $10 for each additional minute of each video and audio item. For expedited filings, FINRA charges $600 for all requests for

rulebook for advertisements and communications appears to be geared toward broker-dealers with large sales forces in multiple branch offices where oversight might be more challenging. Most investment advisory firms are not structured in that fashion.

While the advertising compliance processes are equivalent in substance, some of the content rules vary significantly. Advisers generally are prohibited from using client testimonials or mentioning past specific recommendations in their advertising, while brokers routinely use testimonials. The SEC has also provided extensive guidance and interpretation governing performance advertising. The Request asks for comment on imposing similar content rules for advisers and brokers, but does not appear to seriously contemplate imposing the Advisers Act content restrictions on brokers.

As to the duty to supervise, we agree that "effective supervisory systems and control procedures are important investor protection tools."[62] We submit, however, that equivalent regulation already exists, through NASD Rule 3012 and FINRA Rule 3010 on the one hand and Advisers Act section 203(e)(6), fiduciary duty, and the compliance program rule on the other.[63] As fiduciaries, advisers are obligated to supervise the employees acting on their behalf.[64] Under section 203(e)(6), an adviser (or its personnel) faces liability for failure to supervise its employees unless it (a) has established policies and procedures reasonably expected to prevent and detect violations; and (b) has reasonably discharged its duties under the supervisory system without reasonable cause to believe the procedures were not being complied with. In addition, the compliance program rule requires an adviser to implement policies and procedures to effectively supervise its and its employees' activities. By contrast, the FINRA supervision rules are very specific and detailed, governing assignment of principals to supervise registered representatives, branch office supervision, correspondence review, and the like. Although the regulatory approaches differ (*e.g.*, principles-based vs. rules-based), there is no evidence that the investor protection results differ. Further, given the structure of most advisory businesses – firms with relatively few employees and one office, as contrasted with the typical wirehouse model with employees spread out among various offices, who may require a more structured supervisory system – the FINRA construct is inappropriate and unnecessary.

Similarly, we question the rationale underlying harmonization of the licensing and continuing education requirements currently applicable to brokers. Investment advisory clients must receive detailed information in Part 2B of Form ADV concerning investment personnel who formulate investment advice for a client and have direct client contact, as well as those who have discretionary authority over client assets, even if they do not have direct client contact. The

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expedited review for the first ten pages/minutes and $50 per page/minute in excess of the first ten pages/minutes. *See* http://www.finra.org/Industry/Issues/Advertising/FAQ/#4-3.

[62] Request at 60.

[63] Further, as noted in the 913 Study, the Advisers Act rules governing personal securities trading "are more extensive in certain respects than the requirement that broker-dealers supervise personal securities transactions." 913 Study at 135.

[64] *See* Adviser Regulation, *supra* note 36 at nn. 199-202 and accompanying text.

required information includes a discussion of: (1) educational background and business experience, (2) disciplinary information,[65] (3) other business activities, and (4) any additional compensation that the individual might receive. This information is far more relevant for clients considering the qualifications of their adviser than the "check-the-box" approach to broker-dealer examination and continuing education requirements. In addition, advisers have a fiduciary duty to ensure that their personnel are appropriately competent for the services or strategies that they are providing.

In addition, only 596 of the 6,474 advisers with individual clients provide services *solely* to individual clients.[66] Most advisers serve a variety of types of clients. The current regulatory regime for investment advisers applies flexibly and scalably to the wide range of advisory clients and services provided. By contrast, application of a separate set of rules for individual clients, whether through harmonization with broker-dealer rules or changes to the existing fiduciary duty for such clients, would require the majority of advisers to establish compliance policies and procedures for two separate sets of rules. The costs for investment advisers to comply with all of the possible harmonized rules for licensing, registration and continuing education, supervision, books and records, and client communications and marketing could be substantial. We understand that the Advisor Services division of Charles Schwab & Co., Inc. conducted a survey of advisers to aggregate cost data and will report the results in its comment letter to the Commission. Among other findings, the Schwab Survey indicates that on average adviser compliance costs would more than double in the first year of harmonized rules, and double in each subsequent year. The Schwab Survey also indicates that, depending on the size of the adviser, the substantial additional compliance burdens would take valuable time away from clients and require some firms to hire new staff.

We therefore urge the Commission not to pursue wholesale harmonization efforts. We are aware of no data demonstrating that the broker-dealer regulatory regime is more protective of clients than the Advisers Act regime. On the other hand, converting advisers to the broker-dealer regulatory regime would impose substantial costs on advisers, most of which are small businesses and do not engage in broker-dealer activities, at the expense of investor protection. Further, undifferentiated application of the check-the-box model could erode investment advisers' fiduciary culture of applying a "client's best interest" analysis in all their activities. The Commission should instead focus its efforts on protecting clients receiving investment advice, regardless of whether their financial professional is an investment adviser or a broker-dealer, and address whether any regulatory "gaps" exist only after assuring that broker-dealers provide investment advice to retail clients under a robust fiduciary standard.

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We look forward to working with the Commission to address these important issues. Please contact the undersigned, Karen L. Barr, General Counsel, or Kathy D. Ireland, Associate General Counsel, at (202) 293-4222 with any questions regarding these matters.

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[65] In contrast, broker-dealers only have an obligation to inform their clients that they can access a registered representative's disciplinary history through FINRA.

[66] IARD data as of April 12, 2013.

Respectfully submitted,

David G. Tittsworth
Executive Director

The Hon. Mary Jo White, Chair
The Hon. Elisse B. Walter, Commissioner
The Hon. Luis A. Aguilar, Commissioner
The Hon. Troy A. Paredes, Commissioner
The Hon. Daniel M. Gallagher, Commissioner
Mr. John Ramsay, Acting Director, Division of Trading and Markets
Mr. Norm Champ, Director, Division of Investment Management
Mr. Craig Lewis, Director and Chief Economist, Division of Economic and Risk Analysis

Enclosure: Appendix A

Appendix A: Comparison Matrix of Various Regulations Applicable to SEC-Registered Investment Advisers and Broker-Dealers Providing Advice

Table of Contents

Subject	**SEC Registered Investment Adviser**	**Broker/Dealer**	**Similarities and Differences**
Standard of Conduct			
General Anti-Fraud	Advisers Act Section 206 (prohibiting fraud and manipulative devices) ’34 Act Section 10(b), Rule 10b-5	FINRA Rule 2020 (prohibiting fraud and manipulative or deceptive devices) ’34 Act Section 10(b), Rule 10b-5	Equivalent requirements. In addition, Section 10(b) and Rule 10b-5 apply to both advisers and brokers where appropriate.
Fiduciary Duty	All investment advisers have a comprehensive fiduciary duty to their clients. This duty includes the obligation to act in the client’s best interests and place their client’s interest above their own. It also includes the duty to make full and fair disclosure of all material facts, including potential conflicts of interest. Other obligations that flow from this fiduciary duty include, among others: • the duty to seek best execution • the duty to provide suitable advice • the duty to have a reasonable basis for recommendations • the duty to maintain client confidentiality • the duty to vote proxies in best interest of client, and • the duty to disclose material financial and disciplinary information	No fiduciary duty. Under FINRA Rules: • “High Standard of Commercial Honor and Just and Equitable Principles of Trade” [FINRA Rule 2010] • “Suitability” [FINRA Rule 2111] • “Reasonable Basis” [FINRA Rule 2111]	The Advisers Act fiduciary duty is an overarching principle that applies to every aspect of an adviser’s relationship with its clients and requires that an adviser conduct itself with its clients’ best interests in mind at all times. This principle provides for more comprehensive investor protection, beyond that which can be addressed by specific rules that apply in specific circumstances. The SEC has broad authority to promulgate rules and interpret what constitutes breach of fiduciary duty by an adviser.

Subject	SEC Registered Investment Adviser	Broker/Dealer	Similarities and Differences
Code of Ethics, Personal Trading and Insider Trading	Rule 204A-1: • Written "code of ethics" (including requirements to comply with securities laws and firm standards of conduct, report violations, secure employee acknowledgements) • Holdings and transaction reporting requirements • Pre-approval of IPOs and private placements • Firm standards of business conduct that reflect fiduciary duties	NASD Rules 3040 & 3050: • Duty to disclose accounts • Broker must send duplicate account statements and confirms • Pre-approval for certain private securities transactions	Advisers are required to adopt Codes of Ethics that "set out ideals for ethical conduct premised on fundamental principles of openness, integrity, honesty and trust." (Adopting Release). Codes address conflicts of interest and must ensure that advisory personnel cannot take advantage of their positions. Brokers are not subject to such requirements.
	Advisers Act Section 204A requires policies and procedures to prevent insider trading.	'34 Act Section 15(f) requires policies and procedures to prevent insider trading.	Equivalent regulation already exists for insider trading.
Disclosure			
Initial and Ongoing Disclosure regarding *Investment Advice*	Advisers Act Section 206 - Overarching fiduciary duty to disclose conflicts of interest, compensation arrangements, and other material facts. Advisers Act Rule 204-3 - Form ADV must be provided to each client at the outset of the advisory relationship. – Part 1 available publicly: business information,	No overarching duty '34 Act Rule 17a-5(c) requires disclosure of financial statements.	Advisers are required affirmatively to disclose substantial information about their businesses, their fees and compensation, their conflicts of interest, and their disciplinary history upfront to each client so that the client can evaluate these practices and conflicts in making decisions. Brokers are not generally required to make upfront disclosure to their customers regarding all conflicts of

Subject	SEC Registered Investment Adviser	Broker/Dealer	Similarities and Differences
	disciplinary history, AUM, nature of business and types of clients, compensation arrangements, advisory activities, other business activities, affiliations, extensive private fund information, custody, participation or interest in client transactions, control persons – Part 2A available publicly: advisory business, fees and compensation, performance-based fees and side-by-side management, types of clients, methods of analysis, investment strategies, and risk of loss, conflicts of interest, disciplinary information, other financial industry activities and affiliations, code of ethics, participation or interest in client transactions and personal trading, brokerage practices, review of accounts, client referrals and other compensation, custody, investment discretion, proxy voting, material financial condition – Part 2B for supervised persons: educational background and business experience, disciplinary history, other		interest, compensation arrangements, or disciplinary history. Advisers have an overarching fiduciary obligation to disclose conflicts of interest and other material information and brokers do not. Brokers' disclosure duties are very product and transaction-specific.

Subject	SEC Registered Investment Adviser	Broker/Dealer	Similarities and Differences
	– business activities, additional compensation, and supervision		
Product disclosure	To the extent advisers sell products (*e.g.,* as dual registrants), they must comply with FINRA rules.	FINRA Product-Specific Disclosure Rules: • Penny Stock • CMOs • Options • Variable Annuities • Margin Accounts	Equivalent requirements. To the extent advisers engage in these product sales, they are also required to make product-specific disclosures.
Client Relationship/Sales Practices			
Contract Requirements:	Advisers Act Section 205: • Written Agreement (not required by rule but required in practice) • Performance Fees • No assignment w/o consent • Change in partnership Advisers Act Section 206: • No hedge clauses (except per SEC no-action letter)	In general, written agreements not required by FINRA unless for certain types of products or accounts, *e.g.*: • Penny Stocks • Options • Margin Accounts Mandatory pre-dispute arbitration clauses *(industry practice)*	Advisers and brokers, though not required by rule, typically have written contracts with clients or customers. Advisory contracts are more substantive, reflecting ongoing relationships and contracts for fiduciary services. Advisory contract requirements embed investor protections, while there are no equivalent broker contract rules. Most investment advisory agreements do not include mandatory pre-dispute arbitration clauses. Brokers' contracts typically eliminate the ability of their customers to choose their preferred dispute resolution venue.

Subject	SEC Registered Investment Adviser	Broker/Dealer	Similarities and Differences

Advertising - General (see below for performance advertising)	General anti-fraud provisions of Advisers Act Section 206 and no-action letters:
	• Must be fair and balanced
	• No material misstatements or omissions
	• Past performance no guarantee of future performance, etc.
	
	Advisers Act Rule 206(4)-1:
	• No testimonials
	No past specific recommendations (the conditions for use are so unworkable that the provision is in effect a prohibition)
	• No charts, graphs and other "devices"
	• No "free" reports
	• No material misstatements or omissions
		General principles under FINRA Rule 2210:
		• Must be fair and balanced
		• No material misstatements or omissions
		• Past performance no guarantee of future performance etc.
		
		Process under FINRA Rule 2210 for ads related to advice:
		• Sales Literature
		  ○ Principal approved
		  ○ File certain materials with FINRA
		• Correspondence
		  ○ Monitoring system required
		
		Certain content restrictions under FINRA Rule 2210, including related to testimonials and past specific recommendations
			Equivalent general anti-fraud-type principles.
			
			Advisers are prohibited from using client testimonials or mentioning past specific recommendations in their advertising, while brokers routinely use testimonials (FINRA requirements for testimonials and past specific recommendations not as restrictive as those for advisers).
			
			Equivalent requirements on internal approval of advertising: FINRA requires principal approval for brokers, while the SEC compliance program rule construct provides a framework for firms to ensure that advertisements are not misleading and generally involve internal approval processes.
			
			Equivalent supervisory liability.

Performance Advertising	Anti-fraud liability – Advisers Act Rule 206(4)-1 Extensive interpretive guidance exists through SEC enforcement proceedings and no-action letters, for example related to: • Composite construction • Gross of fees-net of fees	General principles under FINRA Rule 2210 FINRA interpretations under Rule 2210 relate only to mutual funds, *e.g.*: • 1/3/5/10 or Life of Fund performance data for mutual funds • Ban on use of hypothetical or	Equivalent general anti-fraud-type principles. Adviser performance records are highly scrutinized by SEC staff. There is generally no tracking of performance of brokerage accounts.

Subject	SEC Registered Investment Adviser	Broker/Dealer	Similarities and Differences
	• Investment of dividends • Benchmarks • Model results • Portability of performance • Disclosure of conditions, limitations, strategies • Market or economic conditions The Global Investment Performance Standards (GIPS®) are a set of standardized, industry-wide principles that provide investment firms with guidance on how to calculate and report their investment results to clients and prospective clients. The standards address input data, calculation methodology, composite construction, disclosure, presentation and reporting and other topics. Claims of GIPS compliance are closely scrutinized by SEC staff.	synthetic performance for mutual funds • Use of rankings in mutual fund advertisements • Bond fund volatility ratings	Broker-dealers are subject to only specific mutual fund performance rules, which also apply to advisers that manage mutual funds. Many investment advisers comply with GIPS, performance standards issued by the CFA Institute, a professional organization that promotes ethical standards in performance presentation. Firms that claim compliance with GIPS must be verified by an independent third party or disclose that they are not so verified. Claims of GIPS compliance are closely scrutinized by SEC staff. Brokers generally do not claim compliance with GIPS.
Use of solicitors	Cash Referral Fees [Advisers Act Rule 206(4)-3] Requires agreement with solicitor (including solicitor's agreement to comply with Advisers Act) and separate disclosure document to client with disclosure regarding solicitor's compensation and relationship with adviser. Must also disclose referral arrangements on	None related to investment advice or brokerage business generally (MSRB Rule G-38 for brokers in the municipal securities business) Certain finders must register as broker-dealers.	Advisers are subject to detailed rules regarding use of solicitors, while brokers are not. Brokers generally are not required to make disclosures to customers regarding referrals. Advisers Act Rule 206(4)-5 bans advisers' use of solicitors for state and local pension plan business unless the solicitors are certain

Subject	**SEC Registered Investment Adviser**	**Broker/Dealer**	**Similarities and Differences**
	Form ADV.		"regulated persons" (compliance date delayed); SEC/FINRA have not proposed similar rules for brokers soliciting brokerage business other than for brokers in the municipal securities business.
Political contributions	Advisers Act Rule 206(4)-5 imposes two year time out on receipt of compensation if adviser or personnel make certain contributions to officials of government plans who have direct or indirect influence over selecting adviser.	MSRB Rule G-37 political contribution rules for brokers apply only to municipal securities business.	Advisers will be subject to substantial sanctions for contributions to state and local officials. Brokers are subject to equivalent rules only with respect to municipal securities business – not with respect to other services they provide to state and local pension plans (*e.g.*, investment advice, brokerage). FINRA, however, has announced that it will consider proposing similar rules for brokers.
Investment Operations			
Best Execution	Covered under general fiduciary principles and compliance program rule (Advisers Act Rule 206(4)-7). Advisers must seek to obtain the best price and execution on a qualitative basis, taking all factors into account. In selecting a broker, advisers must consider the full range and quality of services provided, execution capability, commission rate, financial responsibility, and responsiveness to the adviser.	Brokers must use reasonable diligence to determine the best market for a security and transact for the client so that the price is as favorable as possible under prevailing market conditions. [FINRA Rule 2320] Post-transaction disclosure obligation ['34 Act Rule 10b-10] Fair price and commissions [FINRA Rules 2230 and 2440]	Equivalent regulation in advisory context. The differences in best execution duties are appropriate for the differing activities involved.

Subject	SEC Registered Investment Adviser	Broker/Dealer	Similarities and Differences
Affiliated Principal Trading Agency Cross Transactions	Prohibited without prior transaction by transaction client consent [Advisers Act Section 206(3)] Client consent required [Advisers Act Rule 206(3)-2]		Advisers Act rules governing principal and agency cross transactions provide strong protections for clients because they require disclosure and consent prior to the transaction. Brokers only have to disclose capacity and terms in after-the-fact confirms.
Proxy Voting	Advisers Act Rule 206(4)-6: Advisers with proxy voting authority must have: • Written policies and procedures reasonably designed to ensure adviser votes client securities in best interest of clients • Public reporting for investment companies, client reporting upon request for all clients • Duty to vote proxies in best interest of client, disclose and mitigate conflicts	NYSE Rule 452 Brokers holding shares as custodian on behalf of customers generally may vote for customers in routine matters if they do not receive instructions but are not subject to any duties in connection therewith. They are prohibited from voting uninstructed shares in executive compensation matters. They typically vote with management without any disclosure to their customers. Otherwise, brokers generally serve a ministerial function in transmitting proxy information to customers.	Advisers are subject to extensive proxy voting regime while brokers are not. Advisers must vote proxies in best interest of the client, and disclose and manage conflicts, while brokers have no such duties. Advisers Act rules reflect an adviser's fiduciary duties to exercise care and loyalty with respect to client assets, including voting rights, where the client delegates voting authority to the adviser. Brokers generally only have administrative functions with respect to proxies.
Compliance Program			
Compliance Program	Advisers Act Rule 206(4)-7: • Written policies and procedures • Designated CCO • Annual review	NASD Rule 3010: • Written policies and procedures • Designated CCO	Equivalent regulation already exists.

Subject	**SEC Registered Investment Adviser**	**Broker/Dealer**	**Similarities and Differences**
Duty to Supervise	Advisers Act Section 203(e)(6) Compliance Program Rule Fiduciary Duty	NASD Rule 3012 FINRA Rule 3010	Equivalent regulation already exists. While the regulatory approaches (*e.g.,* principle-based vs. rules-based) are different, the results are the same.
Custody of Client Assets	Advisers Act Rule 206(4)-2: • Qualified Custodian must hold client funds and securities • Qualified Custodian must send client statements directly to clients • Independent verification of client assets • Internal control report where adviser or affiliate serves as Qualified Custodian	'34 Act Rule 15c3-3: • Segregation of Client Assets ○ Fully paid securities ○ Excess margin securities	Regulations are appropriately tailored to different services provided and address different functions. Broker regulations address the risks of acting as a qualified custodian physically maintaining client assets. Advisers that are not qualified custodians are not permitted to hold client assets. Adviser regulations require use of a qualified custodian and layer additional protections for risks posed by other types of access to client assets (*e.g.,* deemed custody by acting as trustee for trust or as general partner for limited partnership).
AML	OFAC requirements Many firms have AML policies and procedures as a matter of practice.	OFAC requirements Written policies and procedures Designated AML Officer Independent annual audit Training KYC, CIP, SAR	Same OFAC requirements. Equivalent regulation already exists as a matter of practice. Similar to the custody rule, the differences in regulation are appropriate based on different functions. Advisers do not hold cash or process transactions. Advisers have long-term discretionary relationships with clients that do not generally involve

Subject	SEC Registered Investment Adviser	Broker/Dealer	Similarities and Differences
			frequent inflows and outflows into managed accounts. Brokers and banks are subject to AML rules because they process transactions and hold customer assets. They are in a position to monitor transactions and cash flows in accounts.
Privacy	Reg S-P Reg S-AM Reg S-ID	Reg S-P Reg S-AM Reg S-ID	Equivalent regulation already exists.
Record-Keeping	Specified records [Advisers Act Rule 204-2] OCIE interpretive practice	Business as such ['34 Act Rules 17a-3 & 17a-4]	Both record-keeping regimes are outdated and in need of review and modernization. SEC should consider appropriate information to maintain rather than requiring that firms keep all records.
Registration & Licensing Requirements			
Registration	Advisers Act Section 203 and Rule 203-1: Submit Form ADV, Parts 1 and 2A. Parts 1 and 2A are available publicly. In Part 1, provide business information, disciplinary history, AUM, nature of business and types of clients, compensation arrangements, advisory activities,	Section 15(b): Submit Form BD; in Form BD provide information about business, types of business engaged in, and disciplinary history. Applicable state registrations. NASD Rule 1010 Series - Become member of SRO (*e.g.,* FINRA). For FINRA, this includes submission of business and supervisory plan and firm rep interview.	Advisers must submit extensive information initially to SEC, particularly about conflicts of interest (Form BD is not as comprehensive as Form ADV). In order to register and complete Form ADV, advisers must assess and address conflicts of interest, assess risks and establish and implement a compliance program. Key issues with respect to the

Subject	SEC Registered Investment Adviser	Broker/Dealer	Similarities and Differences
	other business activities, affiliations, extensive private fund information, custody, participation or interest in client transactions, control persons. In Part 2A, provide further detail about advisory business, fees and compensation, performance-based fees and side-by-side management, types of clients, conflicts of interest, disciplinary information, code of ethics, methods of analysis, investment strategies, and risk of loss, participation or interest in client transactions and personal trading, financial industry activities and affiliations, custody, investment discretion, brokerage practices, review of accounts, client referrals and other compensation, proxy voting, material financial condition. File Form ADV and submit a fee (“notice file”) with applicable states.		business and compliance program are disclosed in the registration process and to clients. Brokers have FINRA registration requirements in addition to Form BD. The compliance and supervisory aspects are equivalent in substance to the adviser requirements. Other information provided by brokers is more appropriate for the broker business model with its broad range of activities and risks.
Firm Financial Requirements	Form ADV, Part 2A - Audited balance sheet must be provided <u>if</u> adviser proposes to charge >$1,200 in fees per client 6 months or more in advance. Part 2A requires advisers with discretion or custody to disclose to clients any financial condition that is reasonably likely to impair an adviser’s ability to meet contractual commitments to clients.	• ’34 Act Rule 15c3-2: Net Capital • Bonding • Financial Reporting • SIPC	Affirmative disclosure obligation for advisers appropriate to fiduciary relationship. Firm financial standing requirements important for brokers because they maintain custody of customer assets and engage in market making, underwriting, trade settlement and clearing and other activities integral to the functioning of the securities markets. Advisers – unless also registered as broker-dealers – do not engage in these

Subject	SEC Registered Investment Adviser	Broker/Dealer	Similarities and Differences
	Affirmative disclosure obligations under fiduciary duty if an adviser suffers a materially adverse financial event. Bonding with respect to ERISA and investment company clients.		broker-dealer activities or otherwise hold client assets.
Individual Qualification Disclosure	Form ADV Part 2B (brochure supplement) requires disclosure of individual's educational background, business experience, disciplinary information, other business activities, additional compensation and supervision. The supplement must be delivered for each supervised person who provides advisory services to that client.	No affirmative disclosure requirements to clients; disclosure to FINRA on Form U-4 of individuals' education and business background. Customers may seek out information on FINRA BrokerCheck.	An adviser's disclosure of qualifications of its adviser personnel (*e.g.,* Form ADV Part 2B) is more meaningful for client evaluation than examination requirements.
Licensing	State licensing of IA representatives (IARs)	State registration of BD representatives (RRs) FINRA Licensing Regime [FINRA Rule 1030]	Similar licensing regimes – filing of Form U-4 for IARs (all but 3 states) and RRs.
Examinations – advisory personnel	IARs must pass Series 65 or combination of Series 66/7; most portfolio managers have advanced degrees or CFA designation; many financial planners have CFP designation	No examination of investment management knowledge; may have CFP designation Continuing Education [FINRA Rule 1120]	Equivalent regulation; IARs tested on IA knowledge; RRs tested on BD knowledge. Both advisers and brokers are responsible for the training and competence of their personnel.

Subject	**SEC Registered Investment Adviser**	**Broker/Dealer**	**Similarities and Differences**
Examinations – product sales	Series 7 if selling securities products (*e.g.,* dual registrant) Series 6 if selling limited to mutual funds and variable annuities	Series 6 or 7	To extent an individual employed by an adviser sells securities products the individual must be licensed and take Series 6 or 7 examination.
Examination and Oversight			
	OCIE	FINRA OCIE (in conjunction with FINRA, principally oversight role regarding FINRA exams)	Examinations and expertise by each regulator appropriate to types of services overseen by each. SEC resources should be bolstered to increase the frequency of adviser exams.