

August 7, 2018

Honorable Jay Clayton, Chairman  
U.S. Securities and Exchange Commission  
100 First Street NE  
Washington, DC 20210

**Re: Formal Comments on Proposed Rules: Broker-Dealer Regulation Best Interest and Restrictions on the Use of Certain Names or Titles**

Dear Chairman Clayton:

Please accept these formal comments concerning the Securities and Exchange Commission's (SEC) proposed rulemaking package designed to raise the standard that applies to broker-dealers' recommendations and address investor confusion regarding their relationship to investment professionals.<sup>1</sup> As a bipartisan coalition of State Treasurers, we are concerned about the harm to investors that will occur without adequate and necessary fiduciary protections. To adequately safeguard investor interests, there should be one standard – a true fiduciary standard – across all investment types and across all investment professionals.

*Interest of State Treasurers*

As the voice of financial leadership in our respective states, State Treasurers are on the frontlines of America's retirement crisis. Many of us are exploring policies and programs to encourage early savings to assist citizens to achieve basic retirement security. Consistent with our responsibility to prudently manage public funds and possessing the experience and responsibility of prudently investing billions of public dollars, we routinely demand that contracts include a well-articulated standard of care – specifically, a fiduciary standard that obligates managers to act in the sole beneficial interest of the public funds they manage. Unfortunately, individual investors do not have the financial size or scale to insist on the fiduciary investment standard when engaging a private investment manager.

As a consequence of the shift from defined benefit plans to individually directed savings accounts as the primary means of retirement savings, the role of private financial advisers has become more critical to the large and growing number of individual investors. Unfortunately, it is estimated that as many as 45% of working age households have no retirement savings, and that those who do have median balances of only \$3,000.<sup>2</sup> Those with inadequate retirement savings will be compelled to rely on public assistance in their retirement years.<sup>3</sup>

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<sup>1</sup> <https://www.sec.gov/news/press-release/2018-68>

<sup>2</sup> <https://www.nirs.org/reports/the-retirement-savings-crisis-is-it-worse-than-we-think/>

<sup>3</sup> <https://patreasury.gov/pdf/Impact-Insufficient-Retirement-Savings.pdf>

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We write to urge that you develop a regulatory framework that will ensure that all financial professionals put their clients' interests first. Anything less than establishing a strong fiduciary standard for all financial investment professionals will fail the public interest.

### *Comments on Proposed Rules*

#### **I. Regulation Best Interest**

While the proposed broker-dealer Regulation Best Interest rule is a step in the right direction as it requires broker-dealers to act in the best interests of their clients, it does not define the term, "best interest," or explain how it differs from a fiduciary standard that includes duties of loyalty and care. In fact, the ambiguity of the term "best interest" has been criticized by financial industry representatives and investor advocates, including the Investment Adviser Association, the Certified Financial Planner Board of Standards, Chartered Financial Analyst Institute, Consumer Federation of America, Financial Services Institute, and AARP.<sup>4</sup> The ambiguous "best interest" standard does not clearly define the level of care prescribed by the proposed rule. The proposed standard is as follows:

Care obligation: exercise reasonable diligence, care, skill, and prudence, to (i) understand the product; (ii) have a reasonable basis to believe that the product is in the retail customer's best interest; and (iii) have a reasonable basis to believe that a series of transactions is in the retail customer's best interest.<sup>5</sup>

#### *Regulation Best Interest Fails to Establish the Necessary Fiduciary Standard*

The proposed rule does not clearly establish a fiduciary relationship between investment professional and client. For example, it leaves unanswered the question as to whether a broker-dealer must, based on reasonable assumptions and a careful analysis, recommend the investment that is best for the client from among the reasonably available options. It also does not explicitly ensure that brokers who provide ongoing services to customers have an ongoing duty to monitor those customer accounts.

#### *Regulation Best Interest Falls Short in Protecting Investors from Conflicted Advice*

The proposed rule fails to impose a requirement that brokers cannot put their own interests ahead of the client's interests. Following, is a summary of the proposed rule:

Conflict of interest obligation: establish, maintain and enforce policies and procedures reasonably designed to identify and then at a minimum to disclose and

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<sup>4</sup> <http://financialadvisoriq.com/c/2003183/229254>

<sup>5</sup> See Proposed Rule § 240.151-1 Regulation Best Interest (<https://www.sec.gov/news/statements/2018/annex-a-reg-bi-regtext.pdf>)

mitigate, or eliminate, material conflicts of interest arising from financial incentives; other material conflicts of interest must be at least disclosed.<sup>6</sup>

The rule does not prevent broker-dealers from allowing their own interests from tainting client recommendations. The proposed rule is also ambiguous as to the purpose of requiring broker-dealers to “mitigate” financial incentives. The ambiguity of the proposed rule leaves doubt as to whether policies and procedures must be created with an eye towards promoting the best interest standard, and thus to prevent conflicts of interest from influencing investment advice.

Numerous studies demonstrate that conflict of interest disclosure and mitigation is inadequate to reform the broken system and provide investors with necessary protections. The SEC’s own review of research demonstrates that the average retail investor lacks basic financial literacy, with a “weak grasp of elementary financial principles,” and lacks “critical knowledge of ways to avoid investment fraud.”<sup>7</sup> The Department of Labor’s (DOL) Fiduciary Rule acknowledged that investment advice is often conflicted, and that such conflicts are “widespread,” and cause “serious harm” to plan and IRA investors.<sup>8</sup> DOL research further found that the “impact of these conflicts of interest on retirement investment outcomes is large and widespread.”<sup>9</sup> Only by applying a high fiduciary standard to investment advisers and broker-dealers alike will current investor confusion be rectified and the harmful impact of conflicts of interest be addressed.

## II. Restrictions on the Use of Certain Names or Titles

The bifurcated regulatory scheme – one for investment advisers and one for broker-dealers – proposed by the SEC attempts to assuage inevitable investor confusion by placing title restrictions on broker-dealers, as summarized below:

Certain broker-dealers, and their associated persons, would be restricted from using, as part of their name or title, the terms “adviser” and “advisor” — which are so similar to “investment adviser” that their use may mislead retail customers into believing their firm or professional is a registered investment adviser.<sup>10</sup>

### *The Title Restrictions Fail to Consider the Broad Array of Other Misleading Designations*

Restrictions on use of the title “adviser/advisor” are a necessary attempt to protect investors from potential confusion and harm suffered due to relying on the wrong standard of

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<sup>6</sup> See Proposed Rule § 240.151-1 Regulation Best Interest (<https://www.sec.gov/news/statements/2018/annex-a-reg-bi-regtext.pdf>)

<sup>7</sup> <https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf>

<sup>8</sup> <https://www.gpo.gov/fdsys/pkg/FR-2016-04-08/pdf/2016-07924.pdf>

<sup>9</sup> Id.

<sup>10</sup> See Proposed Rule § 240.151-2 Use of the Term “Adviser” or “Advisor” (<https://www.sec.gov/rules/proposed/2018/34-83063.pdf> at page 460)

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care. Regrettably, it falls well short of the mark. It is agreed that brokers should not be allowed to hold themselves out as advisers unless they are also regulated as advisers pursuant to the Investment Advisers Act of 1940. However, the proposed rule does not prevent brokers from switching to the myriad other titles that could mislead the average investor - titles such as “financial consultant” or “wealth manager” – which could be construed as positions that provide investment advice.

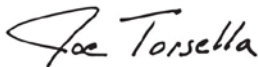
The proposed rule also does not prohibit broker-dealers from describing their services as advice, and it doesn’t prevent them from marketing themselves in ways that are designed to convey a relationship of trust and reliance. Notably, in 2016 the DOL conducted a Regulatory Impact Analysis, which found that “most individuals cannot distinguish between the different types of advisers or the different standards of conduct to which different advisers must adhere, and this confusion is exacerbated by industry marketing and other practices” among broker-dealers and investment advisers.<sup>11</sup> Again, only by requiring broker-dealers and investment advisers alike to adhere to a high fiduciary standard would retail and retirement investors be afforded adequate protections.

### III. Conclusion


As State Treasurers, we strongly urge the SEC to reconsider its proposed different standards of care for broker-dealers and investment advisers. There should be a single uniform standard – the fiduciary standard – for all investment professionals across all investment products. Individual investors, especially those saving for retirement, should expect to receive advice that is untainted by conflicts. Disclosures alone have proven to be insufficient in reducing investor confusion or mitigating financial harm from conflicted advice.

We look forward to a final rule package that establishes a fiduciary standard of care for broker-dealers and that restricts any attempt at abuse from financial professionals.


Sincerely,



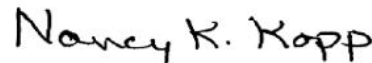
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<sup>11</sup> <https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2> (full report, page 108)

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