

## MEMORANDUM

**To:** File Nos. S7-07-18, S7-08-18, S7-09-18

**From:** Eric Diamond, Senior Advisor to Chairman Jay Clayton

**Re:** Standards of Conduct for Investment Professionals

**Date:** August 17, 2018

---

On August 16, 2018, Chairman Jay Clayton and Eric Diamond (Senior Advisor to Chairman Clayton) met with the following representatives of Charles Schwab:

- Christopher Gilkerson (SVP, General Counsel, Charles Schwab & Co.)
- Jeff Brown (SVP, Head of Legislative and Regulatory Affairs)

The meeting participants discussed, among other things, the SEC's proposed rules and interpretation relating to standards of conduct for investment professionals. At the meeting, the Charles Schwab representatives distributed the attached document.



**KEY POINTS IN CHARLES SCHWAB & CO.  
AUGUST 6, 2018 COMMENT LETTER**

**PROPOSED REGULATION BI**

**PROPOSED FORM CRS**

**COMMENTS ON ADVISER REGULATION**

## SCHWAB'S PERSPECTIVE

- Largest retail broker-dealer and largest custodian for independent RIAs
- Middle ground that best serves retail investors' interests while preserving choice and access to widest range of services
- Recommendations flow from independent retail investor research

# REGULATION BI

- What Retail Investors Say (**see attached**)
- Bottom line: Retail investors are smart but don't (and shouldn't have to) understand nuances in standards
- Solution: Where possible, harmonize BD and RIA requirements and guidance
- Keep focus on the real difference:
  - transactional versus ongoing investment advice service,
  - with corresponding obligations and different ways to pay for advice
- Help representatives: Ease burden of dealing with different standards (ERISA, SEC, State, CFP Board)

# REGULATION BI

- **Recommendations**
  - Use consistent language for best interest:
    - “...shall act in the best interest of the retail customer at the time the recommendation is made, by putting that retail customer's interest first, and without placing the financial or other interest of the broker, dealer or natural person...ahead of the retail customer.”
    - Same as RIA fiduciary obligation, except transactional point in time
    - Addresses some critics' concerns: this is more than suitability
  - **Harmonize obligation of BDs and RIAs to address conflicts of Interest**
    - Conflicts that must be avoided (e.g., product sales contests)
    - Duty to identify, mitigate/disclose or eliminate material conflicts
    - Avoids investor and industry confusion
  - **Disclosure Obligation – Make Clearer that Form CRS can be sufficient**
    - Recognizes that some firms avoid conflicts (e.g., neutral compensation)
    - Reinforces primacy of Form CRS
    - Enables avoidance of largest cost and burden of the Regulation: the point of recommendation disclosure

# FORM CRS

- What Retail Investors Say (**see attached**)
- Bottom line: Investors want concise info about their relationship, and will not benefit from disclosure overload
- Four page “do everything” approach is too much
  - Will not work to have firms discuss other ways clients can receive investment advice at other firms
  - Confusing because vast majority of advisory clients also open brokerage accounts at custodian
  - Advisory accounts are not appropriate for many retail clients, so confusing to include it
  - Key information about the account an investor is interested in gets lost

# FORM CRS

- Better alternative is one page CRS:
  - Visually appealing and digitally friendly
  - Organize around answering 5 key questions
  - With links to RIA Form ADV Part 2
  - With links to BD website or other account information
  - With links to industry education materials (Investor.gov)
  - Consistent with Commissioner and expert views
- Schwab version of the alternative, with benefits (**see attached**)
- Timing and frequency is important
  - Initial, once a year, always on web site
  - Plus at point of transaction under Regulation BI **only** if not covered through Form CRS

## COMMENTS ON ENHANCING ADVISOR REGULATION

- Three overriding concerns: authority, absence of cost-benefit basis, negative impact on small businesses
- Federal licensing and continuing education
  - States have this covered already
- Provision of account statements to show fees
  - Duplicative of what custodians like Schwab already do
  - Could cause investor confusion
  - Instead rely on exam and enforcement authority
- Financial Responsibility Rules
  - Ignores Custody Rule requirement to use qualified custodian
  - Would divert scarce RIA resources

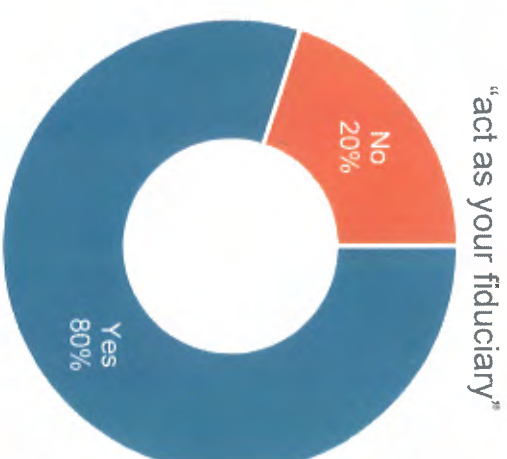
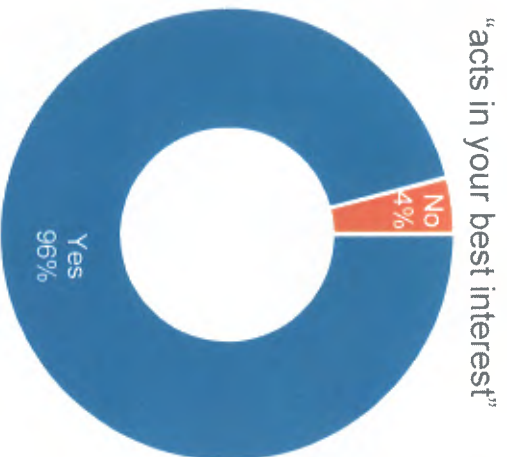


# APPENDIX

Almost all retail investors say they understand the phrase “acts in your best interest”; eight in ten say they understand “act as your fiduciary”

---

Understand the phrases:

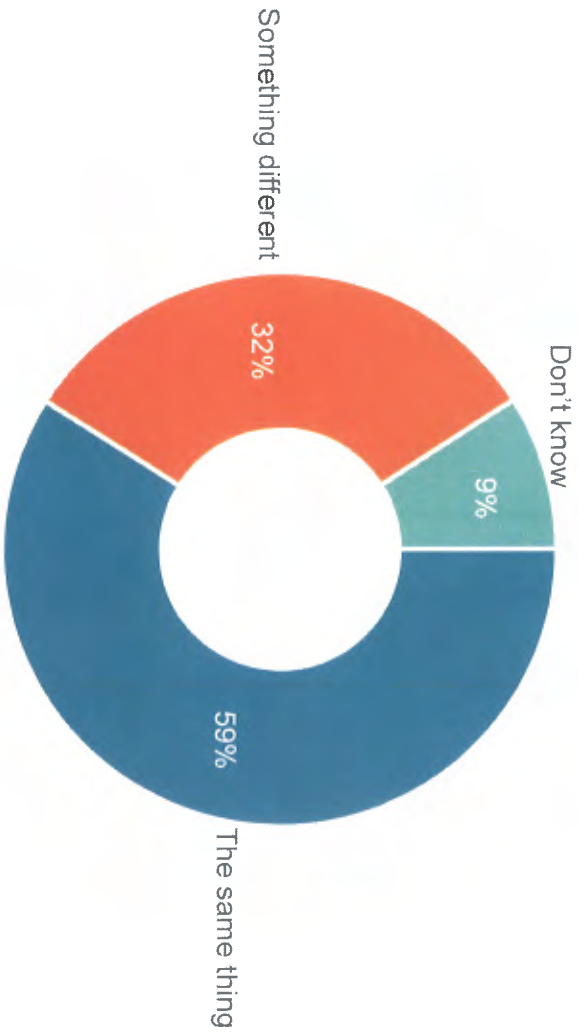


- Q4. When you see the phrase “act as your fiduciary” in the context of someone giving you investment advice, do you have an understanding about what this means? (Base: Total = 1,000)
- Q5. When you see the phrase “acts in your best interest” in the context of someone giving you investment advice, do you have an understanding about what this means? (Base: Total = 1,000)

# Over half of retail investors believe that acting as a fiduciary and acting in your best interest should mean the same thing

---

Acting as a “fiduciary” and acting in your “best interest” in the context of someone giving you investment advice should mean...?



Q6. Acting as a “fiduciary” and acting in your “best interest” in the context of someone giving you investment advice should mean...? (Base: Total = 1,000)

# Almost half of retail investors say brokerage firms and RIAs should both be subject to a fiduciary and best interest standard

## Standards expected for Brokerage Firms and RIAs

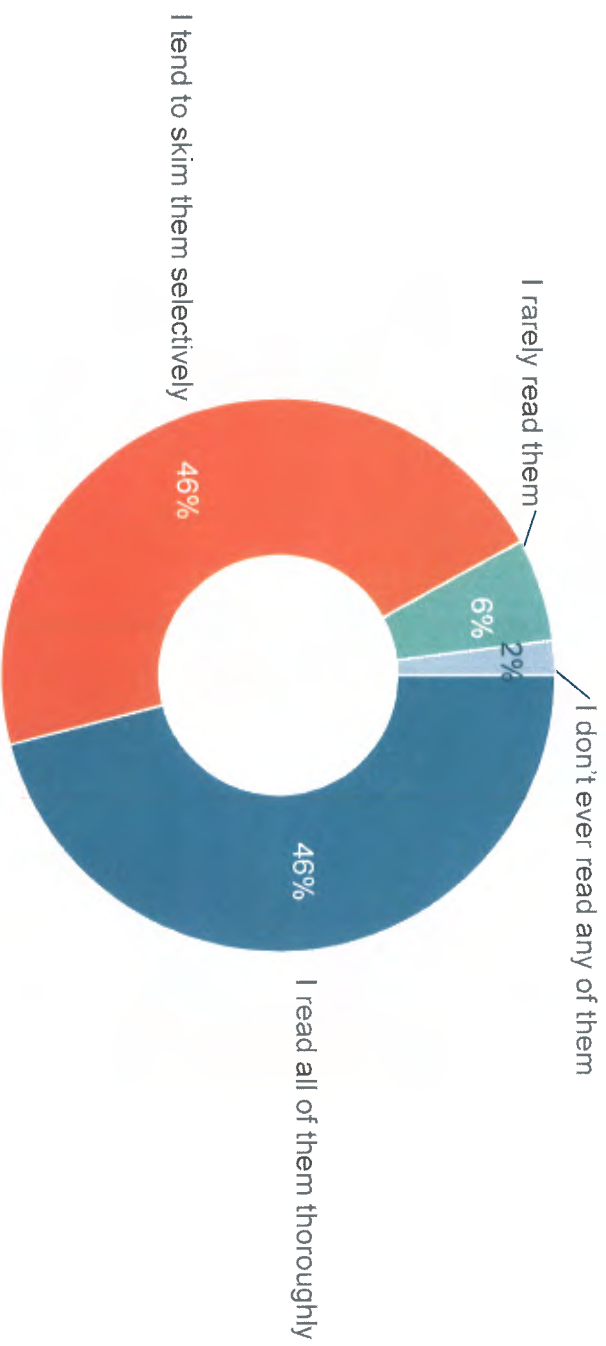


Q8. Whether investment advice comes from a representative of a Brokerage Firm or a Registered Investment Advisor (RIA), do you think they should...? (Base: Total = 1,000)

# As many retail investors say they skim the disclosures as read them thoroughly

---

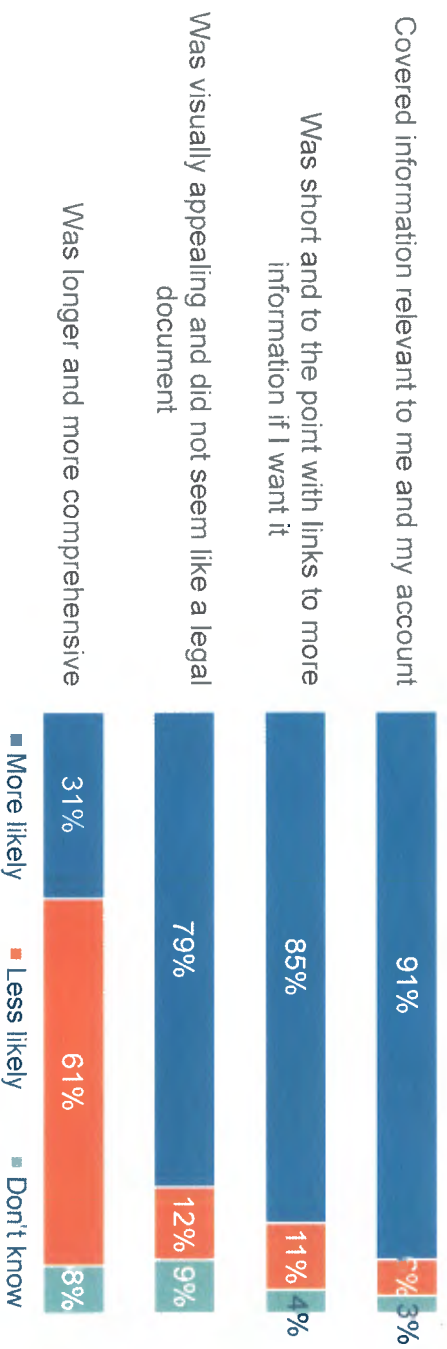
## Approach to reading disclosures



Q11. Which best describes your approach to reading disclosures from the firm(s) you have investment account(s) with? (Base Total = 1,000)

# Disclosures that are relevant, visually appealing, and shorter with links to more information, are more likely to be read

More or less likely to read disclosure if...

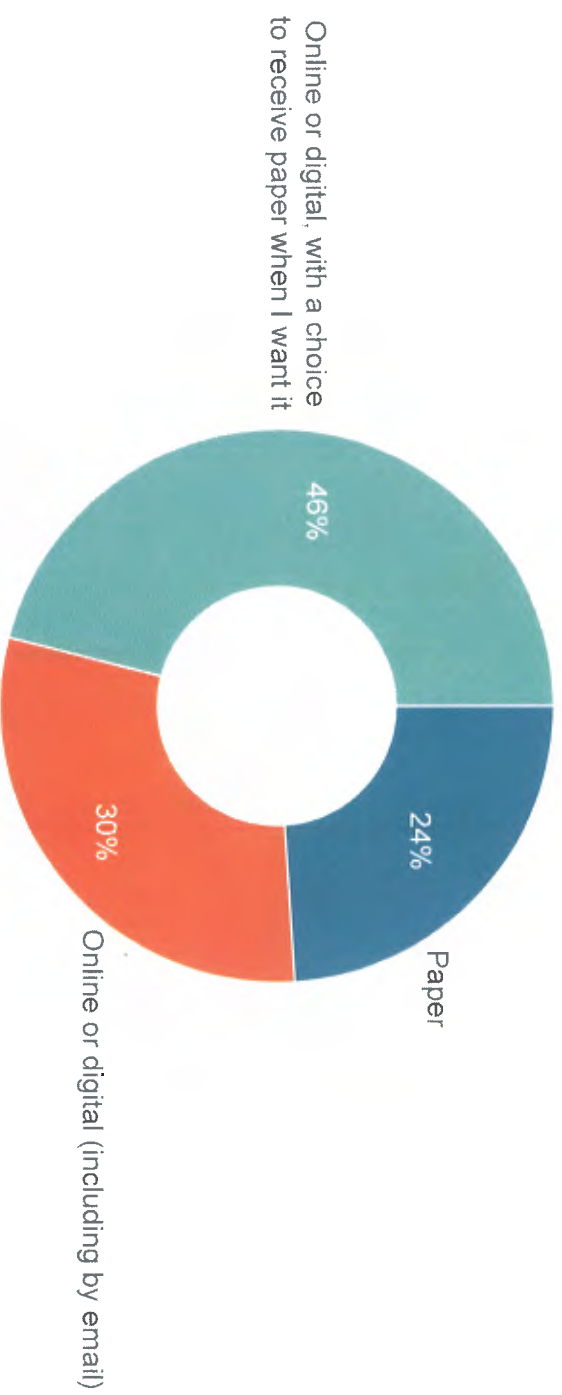


Q12. Would you be more or less likely to read a disclosure if it...? (Base Total = 1,000)

## Retail investors prefer to receive disclosures online/digitally with an option for paper, or just online/digitally

---

Preferred way to receive disclosures about investment advice



Q13. How would you prefer to receive disclosures about investment advice you would receive from a brokerage firm or investment advisory firm? (Base Total = 1,000)

# Retail investors prefer to receive additional information when or before they open their account, plus any updates on an annual basis

## Preferred timing of information from Brokerage Firm or RIA



Q10. Which of the following best describes your preference for when you would like to receive information about how a Brokerage Firm or a Registered Investment Advisor (RIA) does business with you? (Base: Total = 1,000)



# A Summary of Your Brokerage Account Relationship with Charles Schwab & Co., Inc.

The purpose of this summary is to inform you about the nature of our relationship for this and other brokerage accounts you may have with Schwab. For more information, please go to [schwab.com/relationship](http://schwab.com/relationship).

---

What investment advice services do you provide and what are your obligations?

- If we give you investment advice such as recommending an investment or investing strategy, we will act in your best interest and not place our interests ahead of yours.
- You may invest on your own in this account without any advice from us.
- Even when we give you investment advice, you make the final decisions.
- We will not manage or monitor this or other brokerage accounts. Schwab offers investment advisory accounts, which include management of your investments for an ongoing fee. To inquire whether that type of account is right for you, talk to a Schwab representative or go to [schwab.com/investmentadvisory](http://schwab.com/investmentadvisory) to see a summary like this one for advisory accounts.

---

What are the fees and costs for investment advice?

- If you decide to buy or sell a stock, certain exchange-traded funds, mutual funds, or bonds, you will pay a commission or transaction fee. Other investments do not have a commission or transaction fee; instead, the price of the investment includes compensation for Schwab.
- The price you pay is the same whether we recommend an investment to you or not.
- For details on fees and pricing, please go to [schwab.com/pricing](http://schwab.com/pricing).

---

How does your firm make money from investment advice and what are its conflicts of interest?

- Schwab makes more money from some investments you may select compared to others, whether or not a Schwab representative recommends the investment to you.
- For example, Schwab and its affiliates earn more if you purchase a Schwab-affiliated mutual fund or exchange-traded fund than if you purchase one managed by another company.
- For a detailed explanation about how Schwab makes money depending on the investments you choose and our related conflicts of interest, go to [schwab.com/firmcomp](http://schwab.com/firmcomp).

---

How do you pay professionals who give investment advice?

- We compensate our representatives who provide investment advice based on factors such as the amount of client assets they service and the time and complexity required to understand your needs, make recommendations, and provide services to you.
- We do not pay our representatives based on product sales commissions.
- For details on how we pay all of our representatives, please go to [schwab.com/repcomp](http://schwab.com/repcomp).

---

What additional information should I consider?

- For investor education information about different types of investing account relationships and services that may be available to you, and other questions you might want to consider, please visit [www.sec.investoreducation.gov](http://www.sec.investoreducation.gov).
- For free and simple tools to research our firm, our representatives, and other firms, including disciplinary events, please visit [investor.gov](http://investor.gov) and [brokercheck.finra.org](http://brokercheck.finra.org).

# A Layered Approach Leads To More Information

Current Schwab Trading Pricing Hub (would be linked from Form CRS)

- Commissions & Trades
- Account Fees
- Index Fund Expenses
- Transfer Money
- Investment Advice
- Common Questions
- Open Your Account

## Commissions & Trades

— Minimize All

### Stocks & ETFs — Commissions per Trade

	Online Trades	Automated Phone Trades	Broker-Assisted Trades
<b>Stocks</b> <sup>1,10</sup>	\$4.95	\$4.95 + \$5.00 service charge	\$4.95 + \$25.00 service charge
<b>Schwab ETF OneSource</b> <sup>10,2</sup>	\$0	\$0 + \$5.00 service charge	\$0 + \$25.00 service charge
<b>All other ETFs</b>	\$4.95	\$4.95 + \$5.00 service charge	\$4.95 + \$25.00 service charge

### Mutual Funds — Transaction Fees per Executed Trade

	Online Trades	Automated Phone Trades	Broker-Assisted Trades
<b>Mutual Fund OneSource® Service and other No Transaction Fee funds</b> <sup>3</sup>	\$0	\$0	\$25.00 service charge
<b>All other funds</b> <sup>4</sup>	Up to \$76 per buy \$0 per sell	Up to \$76 per buy \$0 per sell	Online pricing + \$25.00 service charge

### Options — Commissions per Trade<sup>5</sup>

	Online Trades <sup>7</sup>	Automated Phone Trades	Broker-Assisted Trades
<b>Options</b> <sup>8</sup>	\$4.95 + \$0.65 Per contract	Online pricing + \$5.00 service charge	Online pricing + \$25.00 service charge

<https://client.schwab.com/secure/cc/products/fees#tradeCommissions>

# Benefits of Alternate One-Page Approach to Form CRS

## Simple

Plain English, easy-to-read content in brief, one-page format.

- Covers key questions and provides answers
- Allows for easier comparison with other firms, as well as necessary tailoring

## Focused

Includes easy-to-understand information on the most important elements of the relationship:

- Services and corresponding obligations
- Fees and costs
- Conflicts of interest
- Additional information, including disciplinary history

## Visual

Employs a variation of the Pew disclosure format, making it easier for investors to find and follow information conveyed.

## Relevant

Focuses on the type of account an investor is in process of selecting (in this case, brokerage).

- Avoids confusion of mixing account types
- Instead, dual registrant links to summaries of advisory accounts
- Website version consolidates all linked information and enables download of comprehensive PDF

## Layered

Q&A approach provides top-line answers on each topic area and links to more in-depth information on company website

## Resourceful

Provides links to investor education materials and objective third-party sites.

### A Summary of Your Brokerage Account Relationship with Charles Schwab & Co., Inc.

The purpose of this summary is to inform you about the nature of our relationship for the end other brokerage relationship you may have with Schwab. For more information, please go to [www.schwab.com/relationships](http://www.schwab.com/relationships).

#### What investment advice services do you provide and what are your obligations?

- If we give you investment advice such as recommending an investment or investing strategy, we will act in your best interest and not place our interests ahead of yours.
- You may invest on your own in this account without any advice from us.
- Even when we give you investment advice, you make the final decisions.
- We will not manage or monitor this or other brokerage accounts. Schwab offers investment advisory accounts, which include management of your investments for an ongoing fee. To learn more, click on the type of advisory link that we give you, under "Schwab-Advisory Accounts" on [www.schwab.com/relationships](http://www.schwab.com/relationships).

#### What are the fees and costs for investment advice?

- If you invest in our direct investments, including mutual funds, your obligations to us, you will pay a commission or trail commission. Other investments do not have a commission or transaction fee. Instead, the price of the investment includes compensation for "Sales" or
- The price you pay in the same whether we recommend an investment to you or not.
- For more on fees and pricing, please go to [schwab.com/pricing](http://schwab.com/pricing).

#### How does your firm make money from investment advice and what are its conflicts of interest?

- Schwab makes more money from selling investments you may select compared to other advisers or not a Schwab representative recommends the investment to you.
- For example, Schwab and its affiliates earn more if you purchase a Schwab-affiliated mutual fund or exchange-traded fund than if you purchase one managed by another company.
- For a detailed explanation about how Schwab makes money depending on the investments, [www.schwab.com](http://www.schwab.com) and our related conflicts of interest go to [schwab.com/investing](http://schwab.com/investing).

#### How do you pay professionals who give investment advice?

- We can provide our professionals' hourly provided investment advice based on factors such as the amount of client assets they serve and the time and resources required to understand your needs, make recommendations, and provide advice to you.
- We do not pay our employees or advisers a fixed or guaranteed fee.
- For details on our applicable compensation, please visit [www.schwab.com/investing](http://www.schwab.com/investing).

#### What additional information should I consider?

- For investor education information about different types of investing, account relationships and services that may be available to you, and other cautions you might want to consider, please visit [www.schwab.com/relationships](http://www.schwab.com/relationships).
- For free and unbiased research, visit our firm, our representatives, and other firms, including objective third-party sites, [www.schwab.com](http://www.schwab.com), and [www.fidelity.com](http://www.fidelity.com).

Illustrative – for discussion only