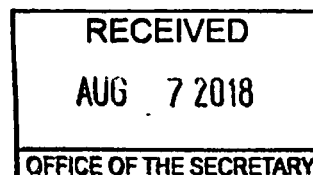


Telephone: Area Code 302 — 529-1500

August 7, 2018

Mr. Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090  
File No. S7-07-18



***Re: Release No. 34-83062; File No. S7-07-18; Regulation Best Interest; Release No. 34-83063; IA-4888; File No. S7-08-18; Form CRS Relationship Summary; Release No. IA-4889; File No. S7-09-18; Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers***

Dear Mr. Fields,

I am writing to comment on the Securities and Exchange Commission's ("SEC" or "Commission") proposed rules to enhance standards of conduct for broker-dealers providing retail investment advice to their customers, Form CRS Relationship Summary, and the Commission's related request soliciting comment on interpreting the fiduciary standard of conduct that applies to registered investment advisers ("RIAs").

My firm, Donald W. Nicholson & Associates, is registered with the Commission as an investment adviser with approximately \$166 million in assets under management. Nicholson & Associates is a father-son advisory firm that provides financial planning and portfolio management services to clients in the Philadelphia-Wilmington area. I would describe my firm as a traditional "Main Street" independent adviser. We act in a fiduciary capacity to all of our clients consistent with the duties of loyalty and care under federal securities law, and consistent with any additional fiduciary duties for advisory services subject to ERISA and state trust law.

Our compensation model is fee-only. We are paid only by our clients in the form of a percentage of assets under management ("AUM"), hourly, or fixed fees such as a retainer for developing a financial plan. By being paid directly by the client and not third-parties, the fee-only compensation arrangement allows us to avoid many of the conflicts of interest associated with myriad forms of indirect and incentive compensation inherent to the broker-dealer business model. I understand and appreciate the challenges facing registered representatives

of a broker-dealer in providing unbiased, client-centric advice inasmuch as I formerly worked on the sell-side many years ago. As an independent RIA, we are able to provide unbiased investment advice without having to avoid or manage the numerous conflicts of interest associated with the broker-dealer business model, and especially those that market proprietary or a limited range of investment products.

It is true that anyone in the financial services industry who is compensated for their investment advice has a built-in conflict of interest, no matter how they are paid. While independent, fee-only RIAs have fewer conflicts when paid solely by the client and no one else, they nonetheless may confront conflicts such as reverse-churning, excessive fees in light of services provided, advising clients on whether to take money out of the AUM portfolio to purchase a house or invest in a business, and soft dollar arrangements. As a member of the National Association of Personal Financial Advisors (“NAPFA”), I must adhere to the NAPFA code of ethics, which prohibits members from taking soft dollars or any form of commission. That said, with respect to the conflicts that investment advisers encounter, they must, under SEC rules and the common law fiduciary standard for investment advisers,<sup>1</sup> either avoid or provide sufficient information about the conflict so that the client can make an informed decision on whether to accept the recommendation. And more importantly, they must act in the client’s best interest.

Regulation Best Interest (“Reg BI”) also requires, at least in concept, broker-dealers and their sales agents providing investment advice to act in the retail customer’s “best interest.” However, nowhere in the actual rule is the term “fiduciary” mentioned, nor is a “duty of loyalty.” At a minimum, one might assume the proposed Form CRS Relationship Summary would succinctly explain the differences between the “best interest” obligations of a broker-agent and the fiduciary duties of an adviser, to better inform an investor when selecting a firm or account. Unfortunately, Form CRS regrettably sheds little light on the differences between the two standards.

As a part of the Form CRS package, SEC staff prepared several model templates illustrating a Form CRS relationship summary. I offer as an example the dual registrant mockup for consideration.<sup>2</sup> In my decades of experience working with clients and explaining the differences between the current suitability obligations of broker-dealers compared to the

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<sup>1</sup> See, e.g., *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 189, 191-192 (1963) (The Investment Advisers Act of 1940 reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.”); *Transamerica Mortgage Advisors v. Lewis*, 444 U.S. 11 (1979) (“[T]he Act’s legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations.”).

<sup>2</sup> See Form CRS Relationship Summary, Dual Registrant Mockup, Appendix C. Available at <https://www.sec.gov/rules/proposed/2018/34-83063-appendix-c.pdf>.

federal fiduciary standard, it is extremely difficult for me to fathom how investors will be able to understand the different market conduct standards in Form CRS. For example, under the category “Our Obligations to You,” firms will be required to use certain boilerplate text to describe those differences. The brokerage side of the side-by-side relationship summary explains how the firm manages broker-dealer conflicts by stating

Our interests can conflict with your interests. When we provide recommendations, we must eliminate these conflicts or tell you about them and in some cases reduce them.<sup>3</sup>

Unfortunately,<sup>4</sup> the adviser column seems to suggest advisers are subject to a lower standard, in which the only remedies are avoidance of the conflict or disclosure. It does not mention that, like Reg BI, advisers are also obligated to act in a client’s best interest. The adviser boilerplate states

Our interests can conflict with your interests. We must eliminate these conflicts or tell you about them in a way you can understand, so that you can decide whether or not to agree to them.<sup>4</sup>

Discerning investors may wrongly leave with the impression (as reinforced in a recent speech by a SEC Commissioner), that RIAs do not have a best interest obligation.

This boilerplate language, if adopted, will only lead to confusion among advisers and brokers in struggling how to explain the differences in follow-up conversations with prospective clients. The same confusion seems to reside at the Commission in the form of contrasting public statements by SEC commissioners and in the proposing releases as well.

For example, SEC Chairman Jay Clayton, in public remarks last spring at Temple University about the regulatory package, said the Commission should “[e]nsure that investors...get clear, plain language answers to these types of [investor] questions from both investment advisers and broker dealers.” He went on to say that these professionals should “follow standards of conduct that embody key fiduciary principles...”<sup>5</sup>

The “clear, plain language” desired by the Commission in Form CRS, and throughout the proposing releases are regrettably clouded by legal obfuscation. And while the Chairman

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<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> SEC Chairman Jay Clayton, “The Evolving Market for Retail Investment Services and Forward-Looking Regulation — Adding Clarity and Investor Protection while Ensuring Access and Choice” (May 2, 2018). Available at <https://www.sec.gov/news/speech/speech-clayton-2018-05-02>.

suggests both kinds of professionals should follow standards “that embody key fiduciary principles,” the proposing release to Regulation Best Interest (“Reg BI”) states, in contrast:

We wish to underscore that proposed Regulation Best Interest focuses on specific enhancements to the broker-dealer regulatory regime, in light of the unique characteristics of the brokerage advice relationship and associated services that may be provided, and therefore *would be separate and distinct from the fiduciary duty* [emphasis added] that has developed under the Advisers Act.<sup>6</sup>

Nowhere does the proposing release provide any details or a policy basis for why the “unique characteristics” of the broker-dealer business model (i.e., that provides retail investment advice) would require a market conduct standard separate and apart from the Advisers Act fiduciary duty in which the advisory firm provides retail investment advice. Nowhere does the Reg BI proposing release acknowledge that much of the retail advisory services offered under both business models are virtually identical. Instead of recognizing the overlap and providing investors with “clear, plain language” to guide investors and industry participants about the differences in market conduct rules, we are inevitable dragged into a dense, 400-plus page abyss of legal distinctions that the Commission itself has struggled to answer. Nor have I seen an in-depth discussion of the differences between the two standards in other Commission statements, or experienced a ‘Eureka’ moment in parsing the dense, technical discussion of the differences in the two proposing releases.

More recently, Commissioner Hester Peirce attempted to distinguish some of the differences in the Best Interest and fiduciary standards during a speech before a pension advisors trade group. In her remarks, Commissioner Peirce suggested that Reg BI may offer significantly greater protection to investors than the ‘40 Act standard because it requires brokerage firms to mitigate or avoid conflicts while the ‘40 Act only requires informed disclosure. In her written remarks Commissioner Peirce states

[A] broker-dealer must either mitigate or eliminate any material financial conflict of interest it may have with its client. An adviser is required only to disclose such a conflict. Rhetoric aside, arguably proposed Regulation Best Interest would subject broker-dealers to an even more stringent standard than the fiduciary standard outlined in the Commission’s proposed interpretation.<sup>7</sup>

I disagree with this point of view. First, it implies that because Reg BI requires brokerage firms to identify and manage conflicts of interest, notwithstanding the absence of a

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<sup>6</sup> Regulation Best Interest, Exchange Act Release No. 34-83062, 43 (Apr. 18, 2018).

<sup>7</sup> SEC Commissioner Hester M. Peirce, “What’s in a Name? Regulation Best Interest v. Fiduciary,” (July 20, 2018). Available at <https://www.sec.gov/news/speech/speech-peirce-072418>.

duty of loyalty, this obligation arguably results in a “more stringent standard” than the federal fiduciary standard for RIA firms. Yet, it ignores the fact that RIAs, too, have supervisory requirements for their fiduciary advice that have been in place since 2003.<sup>8</sup> Moreover, this tightening of supervisory oversight apparently had nothing to do with fiduciary problems at RIA firms, but rather they were swept up in a much broader reform effort by the SEC reacting to other, highly publicized industry scandals.<sup>9</sup>

The perspective that the Advisers Act “only requires informed disclosure” fails to recognize the fiduciary, client-centric culture at independent RIAs, the best-interest standard that is applicable to all of their advisory activities – not just retail advice -- and the simple fact that business models with fewer conflicts are much less likely to run into regulatory problems than business models with multiple conflicts. If the goal of the Commission is to establish two comparable standards, then it should be commended for imposing a heightened supervisory requirement for broker-dealer conflicts, which is not unlike the supervisory requirements that were adopted by the Department of Labor under a prohibited transaction exemption for investment fiduciaries providing conflicted advice.<sup>10</sup>

In summary, the proposing releases of both Reg BI and Form CRS fail to address the fundamental question of what are the differences between the Best Interest standard of a broker under Reg BI, and the Best Interest standard of an adviser subject to a federal fiduciary duty. Nor are the differences addressed in the Commission’s fiduciary guidance.<sup>11</sup> Given this inability to clarify two different but seemingly closely related best interest standards, the prudent approach would be to return to the drawing board. The SEC would be best-served by

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<sup>8</sup> See, Compliance Programs of Investment Companies and Investment Advisers, Release No. IA-2204, File No. S7-03-03 (Dec. 17, 2003). Available at <https://www.sec.gov/rules/final/ia-2204.htm>.

<sup>9</sup> See, e.g. media coverage of a rule by the SEC “that would require [mutual] funds and their advisers to agree to a series of compliance policies and to appoint a chief compliance officer who would report to the directors.” Stephen Labaton, “S.E.C. Proposes Rules to End Late Trading in Mutual Funds,” *The New York Times*, Dec. 4, 2003. Available at <https://www.nytimes.com/2003/12/04/business/sec-proposes-rules-to-end-late-trading-in-mutual-funds.html>. See also media coverage reporting on “One of the largest penalties ever levied by securities regulators.” Associated Press, “Regulators Finalize \$1.4 Billion Wall St. Settlement,” *The New York Times*, Apr. 28, 2003. Available at <https://www.nytimes.com/2003/04/28/business/regulators-finalize-14-billion-wall-st-settlement.html>. The resulting SEC rule to disclose analyst conflicts can be found at Regulation Analyst Certification, Release Nos. 33-8193; 34-47384; File No. S7-30-02, Feb. 20, 2003. Available at <https://www.sec.gov/rules/final/33-8193.htm>.

<sup>10</sup> “Best Interest Contract Exemption,” U.S. Department of Labor, 81 Fed. Reg. 21049 (April 8, 2016). The exemption was later vacated as part of a larger rulemaking package by the U.S. Court of Appeals for the Fifth Circuit.

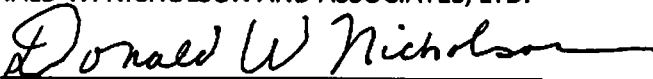
<sup>11</sup> Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release No. IA-4889, File No. S7-09018 (Apr. 18, 2018). Available at <https://www.sec.gov/rules/proposed/2018/ia-4889.pdf>.

following the recommendations of the staff in the Section 913 study<sup>12</sup> by proposing a uniform fiduciary standard applicable to both broker-dealers and RIAs, a standard no less stringent than the standard currently applied under the Investment Advisers Act of 1940.

I urge the Commission to re-consider this common-sense approach to regulation of conflicted investment advice. If both business models provide identical services to retail investors, then it should follow that the Commission would be best-served by creating a level playing field in regulation. This goal, while not easy, would be accomplished by applying a uniform, robust fiduciary standard across-the-board for the securities industry. Doing so would alleviate the need for a Form CRS and a Regulation Best Interest that only promises to exacerbate investor confusion and increase compliance costs. The financial services industry is slowly but surely moving toward a harmonized standard placing the investor's interest first. Adopting a uniform standard for brokers and advisers would greatly enhance public confidence in the securities markets and serve as an example for other regulators.

I am happy to respond to any questions or comments that you may have.

Sincerely,  
DONALD W. NICHOLSON AND ASSOCIATES, LTD.

BY:   
Donald W. Nicholson, Sr.  
President

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<sup>12</sup> See staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers*, January 2011, available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.