PACIFIC LIFE

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May 28, 2019

Filed Electronically

The Honorable Jay Clayton
Chairman
Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

Re: Uniform Standard of Care for Financial Professionals

Dear Chairman Clayton:

The SEC has long opined that a registered investment adviser ("RIA") is a fiduciary, and as a fiduciary must act in the client's best interest. But, this left open the question of whether the opposite is true. That is, if any other financial professional acts in their client's best interest, does that make the financial professional a fiduciary? This question (and feared affirmative answer) has chilled the advancement of and support for a uniform best interest standard, and we do not believe it needs to be so.

Pacific Life implores you to end the confusion by defining one single "best interest" standard of care for all financial professionals. From there, the distinction between relationships that are fiduciary and non-fiduciary can easily be distinguished based on the nature of the relationship and the level of control the financial professional has over the consumers' assets.

"The beginning of wisdom is the definition of terms." – Socrates

Numerous reports[1], surveys, and focus groups continue to show that consumers neither understand nor appreciate differences in "standards of care" or even what a "standard of care" is generally. Consumers also do not understand how financial professionals' roles and responsibilities vary based solely on their title. If you were to simply ask a consumer whether they would want their financial professional to act in their best interest or, alternatively, act as a fiduciary, the everyday consumer will almost certainly say "best interest" because the words are easily understood. Beyond that, it would be highly unlikely the consumer would even know what a fiduciary is or does (or why, if, and how a fiduciary is any different than a non-fiduciary financial professional in the consumer's expectations as to service, honesty, and integrity).

[1] For example, RAND Institute, *Investor Testing of Form CRS Relationship Summary*, November 2018.

To truly end the confusion, for both consumers and financial professionals, Pacific Life supports a harmonized "best interest" standard of care for all financial professionals, regardless of what they are called, licenses they hold, etc. In other words, from the consumer's perspective, if the person sitting across from the consumer providing financial advice calls themselves an "adviser," a " broker," an "insurance producer," a "wealth manager," a "financial planner" or "financial consultant" – regardless – that person is expected to act in the consumer's best interest in the same exact way. There can only be one uniform standard of care applicable to all, but we must also leave room for distinctions such as a fiduciary duty standard as we explain below.

Ultimately, we must create a regulation that can reasonably be understood by consumers, complied with by financial professionals, enforced by the applicable regulatory agencies, and requires *all* financial professionals to act in their clients' best interest. Despite the deafening noise coming from numerous interested parties, the means to get there is not that complicated.

What Makes a Financial Professional a Fiduciary?

A starting point is to define and then distinguish the terms "Fiduciary" and "Best Interest" so that while all financial professionals must act in their clients' best interest (in the same way), only those certain financial professionals who agree to a "special relationship" with their client based on the services they provide will be held to the heightened fiduciary standard. Put simply, acting in someone's best interest should not be exclusively attributed to a fiduciary, and only when certain circumstances are present should a financial professional be held to the heightened responsibilities of a fiduciary. The term "fiduciary" needs to be defined and remain distinguished in law, but fully understanding the legal distinction should *not* be expected of consumers in the everyday consumer experience as noted above.

Generally, a common element of when a fiduciary relationship arises under the law is that a person (entrustee; the "fiduciary") enters into a "special relationship" with another person or entity (entrustor) and the fiduciary is entrusted with the entrustor's well-being, property, assets, money, etc., for an ongoing stated or agreed to period of time. The fiduciary is typically given discretionary authority/control by the entrustor over the entrusted person or property. Trusting another person with your well-being or property, and giving them dominion and control/discretion over decisions related to your well-being or property over time, is what makes the fiduciary arrangement a "special relationship." As a result, the expectation under law is that the fiduciary has a more "heightened" duty to the entrustor, and must act on that entrusted property in utmost good faith and fidelity to the entrustor.

Our industry and those who regulate us understand that not all financial professionals have agreed to enter into that "special *fiduciary* relationship" with their client – to take dominion and control of their assets through a grant of discretionary authority from the client, where the financial professional has agreed to an obligation to manage, monitor, and review that client financial portfolio on an ongoing basis in the utmost good faith and fidelity to their client. These *added* responsibilities of a financial professional would rise to the level of a *true* fiduciary duty, and the appropriate heightened level of scrutiny under law and precedent that accompanies that responsibility.

Current SEC Definitions

We believe that while the SEC framed this issue in so many words, it failed to articulate it with the specificity needed in a way that clearly drew that distinction for our industry and others. In 2018, as a companion to Regulation Best Interest ("Reg. B.I."), the SEC made a request for comments regarding "Areas of Enhanced Investment Adviser Regulation." Therein, the SEC described the core components of an Investment Advisers' *Fiduciary* Duty:

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1. **Duty of Care**
   - Duty to Provide Advice that is in the Client's Best Interest
   - Duty to Seek Best Execution
   - Duty to Act and to Provide Advice and Monitoring over the Course of the Relationship

2. **Duty of Loyalty**
   - Put the Client's Interests First
   - Make Full and Fair Disclosure to its Clients of all Material Facts Relating to the Advisory Relationship
   - Seek to Avoid Conflicts of Interest, and, at a minimum, Make Full and Fair Disclosure of all Material Conflicts of Interest that Could Affect the Advisory Relationship

In a harmonized best interest standard, the shaded components as built into Reg. B.I. would now be common requirements for both brokers and RIAs, and would be completely understandable to and expected by a consumer. From the consumer perspective, no matter what type of financial professional the consumer is working with (broker or advisor), these core elements would apply.

Proposed SEC Definitions

In this harmonized framework, how does one go, then, from a non-fiduciary best interest standard to be a fiduciary? It may depend on specific state law or facts and circumstances in some situations, but the SEC already has in place the additional components outlined above (unshaded) that create a fiduciary duty for RIAs – the duty of best execution anticipates a discretionary relationship, and the requirement to provide ongoing advice and monitoring over the course of the client relationship clearly distinguishes a fiduciary relationship from other financial professional activities that are simply transaction-based where the consumer maintains control of and is the ultimate decision maker regarding disposition of their assets. Both of these requirements are clearly and rightly absent in SEC's proposed Reg. B.I. that specifically targeted non-fiduciary broker-dealers. Therefore, simply stated, in addition to the best interest requirements applicable to all, a "fiduciary" would have the additional unique responsibilities tied to discretionary control/authority over their clients' assets, and the ongoing obligation to oversee and monitor those assets. And, as already required today, because these additional duties must be fully understood by a consumer, it must be clearly delineated in written summary form to the client.

Once the SEC finalizes the best interest core elements enumerated in Reg. B.I., other prudential regulators would undoubtedly move forward based on these same harmonized themes (there is no doubt others are waiting to see what the SEC does). Once the harmonized core best interest elements are agreed to by others, each prudential regulator can then tweak or augment their own regulations, rules, procedures, licensing standards, etc. to address their unique industry requirements and markets they serve. That is, FINRA rules for a broker-dealer and registered representatives, SEC requirements for RIAs, underlying insurance laws and regulations for insurance producers, organizational codes of conduct for other entities or groups such as Certified Financial Planners, etc.

Conclusion

A common post-Reg. B.I. industry concern has been – by adhering to the Reg. B.I. components, does it make the non-fiduciary a fiduciary, and have we now lost the important legal distinction between a fiduciary and a non-fiduciary? We do not believe the SEC intends that all financial professionals adhering

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to the Reg. B.I. components would be considered fiduciaries, but this frequent misunderstanding illustrates the need for further clarification of what makes a financial professional a fiduciary.

Ultimately, considering everyone a fiduciary (as, for example, consumer groups and certain states' legislators have supported) will dilute the important significance of being a fiduciary; and diminish the special relationship born from this arrangement and the existing legal precedents supporting it. It will certainly be less confusing to the consumer if *all* financial professionals are required to act in their best interest regardless of title or license without also being tasked to understand the significant legal differences between fiduciaries and non-fiduciaries.

We believe it is important for the SEC to clearly state within Reg. B.I. that only the financial professionals that agree to take dominion and control of the consumer's assets through a grant of discretionary authority, coupled with an obligation to manage, monitor, and review that client portfolio on an ongoing basis, rise to that "special fiduciary relationship" with the consumer (and thus also be required to be a Registered Investment Adviser and all that entails). We believe the better way to achieve our shared goal of requiring financial professionals to act in the consumer's best interest, and still maintain the important legal distinction of being a fiduciary, must begin with the definition of terms (we have attached a few ideas in the appendix, and refer you to our earlier letters in response to Reg B.I. also enclosed).

Thank you again for the opportunity to share our views on this important regulatory effort. Pacific Life supports a uniform best interest standard of care applicable to all financial professionals and we stand ready to help you find the right path forward.

Sincerely,

Sharon A. Cheever

Sharon Cheever
Senior Vice President and
General Counsel

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APPENDIX I

We prepared this chart to compare the obligations financial professionals would adhere to under a uniform best interest standard of care.

BROKER	ADVISER
Best Interest Obligation: Shall act in the best interest of the retail customer at the time the recommendation is made ***(§ 240.15l-1 Regulation Best Interest "Reg. B.I." (a)(1))*** Without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer ***(Reg. B.I. (a)(1))***	*Best Interest Duties/Obligation:* Duty to Provide Advice that is in the Client's Best Interest ***(Duty of Care)*** Put the Client's Interests First ***(Duty of Loyalty)***
Disclosure Obligation: Discloses to the retail customer, in writing, the material facts relating to the scope and terms of the relationship ***(Reg. B.I. (a)(2)(i))*** Including all material conflicts of interest that are associated with the recommendation ***(Reg. B.I. (a)(2)(i))***	*Disclosure Obligation:* Make full and fair disclosure to its clients of all material facts relating to the advisory relationship ***(Duty of Loyalty)*** Seek to avoid conflicts of interest, and, at a minimum, make full and fair disclosure of all material conflicts of interest that could affect the advisory relationship ***(Duty of Loyalty)***

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BROKER	ADVISER
Care Obligation: ***(Reg. B.I. (a)(2)(ii))*** Exercises reasonable diligence, care, skill, and prudence to: (A) Understand the potential risks and rewards associated with the recommendation (B) Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile (C) Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile	*Care Obligation:* Act with reasonable diligence, care, knowledge, skill and prudence; ***(Proposed Amended § 275.204A–1; See Appendix III)*** Only recommend investments and strategies for which the adviser is reasonably knowledgeable and competent; ***(Proposed Amended § 275.204A–1)*** Ensure there is a reasonable independent basis for any investment advice or recommendation and that it meets the client's financial needs and financial objectives consistent with the client's facts and circumstances as set forth in the client profile information; ***(Proposed Amended § 275.204A–1)***
Conflict of Interest Obligation: ***(Reg. B.I. (a)(2)(iii)):*** (A) The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendations. (B) The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations	*Conflict of Interest Obligation:* Identify and manage conflicts of interest, avoid or mitigate material conflicts of interest, and provide effective written disclosure of material conflicts of interest to the client ***(Proposed Amended § 275.204A–1)***
Fiduciary Duty NONE ***(Proposed addition Reg. B.I. as 240.15l-1(a)(3); See Appendix II)***	*Fiduciary Duty* Duty to seek best execution ***(Duty of Care)*** Duty to act and to provide advice and monitoring over the course of the relationship ***(Duty of Care)***

APPENDIX II

In order to be clear, and affirmatively state that Reg. B.I. does not create a fiduciary duty, Pacific Life proposes that the SEC add to Reg. B.I. as 240.15l-1(a)(3):

(3) Fiduciary Duty

(i) This Regulation is not intended to create a "fiduciary relationship" other than as already defined under current state or federal law, or in a written agreement between the broker, dealer, or a natural person and the retail customer.

(ii) Adherence to this Regulation by a broker, dealer, or a natural person does not create a "special relationship" of *heightened* "trust and/or confidence" other than as already defined under state or federal law, or in a written agreement between the broker, dealer, or a natural person and the retail customer.

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APPENDIX III

In their August 31, 2017, comment letter to Chairman Clayton, the Investment Adviser Association ("IAA") enumerated several components of the fiduciary standard that they believe already exist for fiduciaries (see Section C.1. on page 7 of 11 in the attached):

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

Because we agree historically these standards have been principles based, it would be very helpful for the SEC to actually state these standards more affirmatively (since the IAA agrees the investment adviser fiduciary is already responsible to do so) in order to have a more concrete basis to compare similarities and differences in roles under a best interest regime. For example, a relatively simple fix would be to amend 275.204A (17 C.F.R. 275.204A-1), as per the attachment, to reflect these very same IAA enumerated standards, but do so highlighting the "best interest" components (that should align with a broker's duties under Reg. B.I.) as distinct from but in addition to the additional fiduciary components needed because the investment adviser is taking dominion and control over their customer's assets.

Similar to the discussion in our comment letter, a point of confusion are the words "trust and confidence" as interpreted to be uniquely descriptive of a fiduciary relationship. But this is not accurate. We would hope that a consumer would have "trust and confidence" in their broker and insurance producer as well. It is a "special relationship" of truly special heightened and enhanced "trust and confidence" that a consumer places in someone they are giving dominion and control of their person or their assets that creates a fiduciary duty in that person. Similar to "best interest," "trust and confidence" alone are not indicia of a fiduciary relationship. Clearly, there is more to it than that.

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APPENDIX IV

To show what harmonization could look like across the board, we prepared this chart to assist others to see that what has been proposed to date is consistent with each other and even with the outside standard that consumer groups and others hold as the gold standard (the Certified Financial Planners Code of Ethics). Please see attached titled "Comparison of Standards of Care."

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INVESTMENT ADVISER ASSOCIATION

August 31, 2017

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

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

Dear Chairman Clayton:

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

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

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

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

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

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

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

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A. Summary of Position

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

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

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

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

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

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

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

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

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

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

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

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

B. Background

Investor Confusion Persists

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

Existing Legal Framework

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

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

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

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

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

[11] FINRA Rule 2010.

The SEC's Consideration of the Issue

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

The Financial Crisis and the Dodd-Frank Act

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

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

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

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

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

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

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

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

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

The Department of Labor's Fiduciary Rule

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

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

C. Recommendations

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

* * * *

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

Respectfully,

Gail C. Bernstein
General Counsel

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

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

17 C.F.R. § 275.204A–1

§ 275.204A–1 Investment adviser codes of ethics.

Effective: May 22, 2017

(a) Adoption of code of ethics. If you are an investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b–3), you must establish, maintain and enforce a written code of ethics that, at a minimum, includes:

(1) A "best interest" standard (or standards) of business conduct that you require of your supervised persons, which standard must reflect your obligations and those of your supervised persons when providing personalized investment advice to retail clients to:

a. place the client's interest above the financial interest of the adviser and the adviser's supervised persons;
b. act with reasonable diligence, care, knowledge, skill and prudence;
c. only recommend investments and strategies for which the adviser is reasonably knowledgeable and competent;
d. make full and fair disclosure to clients of all relevant material facts and investment information such as features, risks and charges;
e. ensure there is a reasonable independent basis for any investment advice or recommendation and that it meets the client's financial needs and financial objectives consistent with the client's facts and circumstances as set forth in the client profile information;
f. make reasonable inquiry into the client's financial situation, investment experience, risk tolerance, and investment objectives (client profile information);
g. disclose the types, scope and duration of services provided, and fees charged;
h. make no misleading statements; and
i. identify and manage conflicts of interest, avoid or mitigate material conflicts of interest, and provide effective written disclosure of material conflicts of interest to the client.

(2) A standard (or standards) of business conduct that you require of your supervised persons, which standard must reflect your additional fiduciary obligations and those of your supervised persons:

a. seek best execution; and
b. provide advice and monitoring over the course of the client relationship.

Note: Highlighted portions indicate suggested changes

Comparison of SEC Proposed *Regulation Best Interest*, NAIC 11-19-18 Draft Proposed Amended *Suitability in Annuity Transactions Model Regulation,* and the *Certified Financial Planners(CFP) Code of Ethics and Standards of Conduct*

SEC Proposed Regulation Best Interest	**NAIC 11-19-18 Draft Model**	**CFP Code of Ethics and Standards of Conduct**
Best Interest Obligation. A broker, dealer…. when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer, <u>shall act in the best interest of</u> the retail customer at the time the recommendation is made, <u>without placing</u> the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation <u>ahead of</u> the interest of the retail customer.	Duties of Producer or Insurer A producer, or an insurer where no producer is involved, when making a recommendation of an annuity, <u>shall act in the *interests* of</u> the consumer at the time the recommendation is made …. [by] [Section 6.A.(1)] <u>without placing</u> the producer's or the insurer's financial interest <u>ahead of</u> the consumer's interests [Section 6.A.(1)]	*Code of Ethics* 2. <u>Act in the client's best interests</u>. *Standards of Conduct* .. when providing Financial Advice to a Client, a CFP must act as a <u>fiduciary</u>, and therefore, <u>act in the best interests of</u> the Client. Act <u>without regard to</u> the financial or other interests of the CFP …. which means ….. <u>place the Client's interests above the CFP</u>'s [Section A.1.]
Disclosure Obligation. The broker, dealer, ….. prior to or at the time of such recommendation, <u>reasonably discloses</u> to the retail customer, in writing, the material facts relating to the <u>scope and terms of the relationship</u> with the retail customer, including all <u>material conflicts of interest</u> that are associated with the recommendation.	Prior to or at the time of the recommendation or sale of an annuity, the producer, or insurer where no producer is involved, <u>shall prominently disclose</u> to the consumer: [Section6.B.] Disclose a description of the <u>scope and terms of the relationship</u> with the consumer and the role of the producer in the transaction [Section 6.C.(1)] Disclose any and all <u>material conflicts of interest</u> [Section 6.C.(5)]	When providing or required to provide Financial Planning ... a CFP <u>must provide</u> the following information to the Client, prior to or at the time of the Engagement, <u>in one or more written documents</u>: iii. The terms of the Engagement between the Client and the CFP …, including <u>the Scope of Engagement</u> and any limitations, the period(s) during which the services will be provided, and the Client's responsibilities. [Section A.10.b.]

Comparison of SEC Proposed *Regulation Best Interest*, NAIC 11-19-18 Draft Proposed Amended *Suitability in Annuity Transactions Model Regulation,* and the *Certified Financial Planners(CFP) Code of Ethics and Standards of Conduct*

SEC Proposed Regulation Best Interest	**NAIC 11-19-18 Draft Model**	**CFP Code of Ethics and Standards of Conduct**
Care Obligation. Exercise reasonable diligence, care, skill, and prudence B. Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks and rewards associated with the recommendation;	Acting with reasonable diligence, care, skill and prudence [Section 6.A.(2)] Have reasonable ground for believing the recommendation is suitable for the particular consumer [Section 6.B.(3)] Consider the types of products the producer, or insurer where no producer is involved, is authorized and licensed to recommend or sell that may align with the consumer's disclosed consumer profile information and address the consumer's financial situation, objectives, and needs; [Section 6.B.(2)] "Suitable" means a recommendation of an annuity that is consistent with the consumer's insurance needs and financial objectives based upon the facts disclosed by the consumer or known at the time of the recommendation by the producer, or insurer where no producer is involved. [Section 5.O.]	*Code of Ethics* 3. Exercise due care. *Standards of Conduct* Duty of Care. A CFP must act with the care, skill, prudence, and diligence that a prudent professional would exercise in light of the Client's goals, risk tolerance, objectives, and financial and personal circumstances. [Section A.1.b.]
Conflict of Interest Obligation. ……identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations	[See above disclosure requirement in Section 6.C.(5)] "Material conflict of interest" means a financial interest of the producer, or the insurer where no producer is involved, in the sale of an annuity that a reasonable person would expect	*Code of Ethics* 4. Avoid or disclose and manage conflicts of interest *Standards of Conduct* Duty of Loyalty. A CFP must:

Comparison of SEC Proposed *Regulation Best Interest*, NAIC 11-19-18 Draft Proposed Amended *Suitability in Annuity Transactions Model Regulation,* and the *Certified Financial Planners(CFP) Code of Ethics and Standards of Conduct*

SEC Proposed Regulation Best Interest	NAIC 11-19-18 Draft Model	CFP Code of Ethics and Standards of Conduct
	to influence the impartiality of a recommendation. [Section 5.K.]	i. Place the interests of the client above the interest of the CFP; ii. Avoid Conflicts of Interest, or fully disclose Material Conflicts of Interest to the Client, obtain the Client's informed consent, and properly manage the conflict; iii. Act without regard to the financial or other interests of the CFP …. which means …. place the Client's interests above the CFP's [Section A.1.a]
Retail Customer Investment Profile includes, but is not limited to, the retail 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 retail customer may disclose to the broker, dealer, or a natural person who is an associated person of a broker or dealer in connection with a recommendation.	*"Consumer profile information"* means information that is reasonably appropriate to determine whether a recommendation is in furtherance of the consumer's interests, including the following: (1) Age; (2) Annual income; (3) Financial situation and needs, including debts and other obligations; (4) Financial experience; (5) Financial objectives; (6) Intended use of the annuity; (7) Financial time horizon; (8) Existing assets or financial products, including investment, annuity and insurance holdings; (9) Liquidity needs; (10) Liquid net worth; (11) Risk tolerance, including willingness to accept non-guaranteed elements in the annuity,	*Obtaining Qualitative and Quantitative Information*. A CFP® must describe to the Client the qualitative and quantitative information concerning the Client's personal and financial circumstances needed …and collaborate with the Client to obtain the information. i. Examples of qualitative or subjective information include the Client's health, life expectancy, family circumstances, values, attitudes, expectations, earnings potential, risk tolerance, goals, needs, priorities, and current course of action. ii. Examples of quantitative or objective information include the Client's age, dependents, other professional advisors, income, expenses, cash flow, savings, assets, liabilities, available

SEC Proposed Regulation Best Interest	**NAIC 11-19-18 Draft Model**	**CFP Code of Ethics and Standards of Conduct**
	including variability in premium, death benefit or fees; (12) Financial resources used to fund the annuity; and (13) Tax status. [Section 5.D]	resources, liquidity, taxes, employee benefits, government benefits, insurance coverage, estate plans, education and retirement accounts and benefits, and capacity for risk. [Section C.1.a]
From: *Hypothetical Relationship Summary for a Registered Broker-Dealer Prepared By SEC Staff Disclose Fees and Costs* (**See Hypothetical for complete disclosures**) If you open a brokerage account, you will pay us a ***transaction-based fee,*** generally referred to as a commission, every time you buy or sell an investment.	Prior to or at the time of the recommendation or sale of an annuity, the producer, or insurer where no producer is involved, shall prominently disclose to the consumer: [Section6.B.] A description of the sources and types of cash compensation to be received by the producer [Section 6.C.(3)] The type of non-cash compensation that exceeds $500 per producer per year the producer may receive [Section 6.C.(4)]	When Providing Financial Advice. When providing or agreeing to provide Financial Advice …, a CFP must provide .. to the Client, prior to or at the time of the Engagement, and document that the information has been provided to the Client: i. A description of the services and products to be provided, how the Client pays for the products and services, and how the CFP and the CFP's Firm are compensated for providing the products and services; ii. How the Client pays for the products and services, and a description of the additional types of costs that the Client may incur, including product management fees, surrender charges, and sales loads; iii. How the CFP, the CFP's Firm, and any Related Party are compensated for providing the products and services; Identification of any Related Party that will receive compensation for providing services or offering products; [Section A.10.a.]

Comparison of SEC Proposed *Regulation Best Interest*, NAIC 11-19-18 Draft Proposed Amended *Suitability in Annuity Transactions Model Regulation,* and the *Certified Financial Planners(CFP) Code of Ethics and Standards of Conduct*

SEC Proposed Regulation Best Interest	NAIC 11-19-18 Draft Model	CFP Code of Ethics and Standards of Conduct
	Drafting Note: The NAIC acknowledges that the goal of the U.S. Securities and Exchange Commission's (SEC) April 2018 proposals is to move toward a harmonized best interest standard of conduct for broker-dealers and agents that substantially raises the professional obligations for recommendations, while preserving and differentiating the fiduciary standard for investment advisers. As of the November 2018 Draft of the amended *Suitability in Annuity Transactions Model Regulation* (#275), the SEC's proposed use of the term "b est interest" in the actual text of the SEC's Regulation Best Interest proposal appears to describe "best interest" as including "best interest" wit hout further definition and is not distinguished from the investment adviser fiduciary. The SEC has received many public comments on use of t he phrase "best interest" and may provide greater clarity in its final rule. While the NAIC fully supports a similar goal of a harmonized standard of conduct, and has a strong preference to remain consistent with FINRA rules in connection with a recommendation of variable annuities, the NAIC is not yet convinced that this November 2018 Draft of the amended	

SEC Proposed Regulation Best Interest	NAIC 11-19-18 Draft Model	CFP Code of Ethics and Standards of Conduct
	Suitability in Annuity Transactions Model Regulation (#275) is legally distinct from the enhanced standards that are intended by the SEC. Until such time the NAIC can evaluate any di stinction in the text of the SEC proposal between a "best interest" recommendation a nd investment adviser fiduciary duties, and the SEC and FINRA have finalized relevant terms, definitions and related requirements, the NAIC would opt to refrain from using the phrase "best interest" in Section 6A(1) of the proposed modifications to the *Suitability in Annuity Transactions Model Regulation* (#275).	

SHARON A. CHEEVER
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August 3, 2018

Filed Electronically: rule-comments@sec.gov

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

Re: Comments in Response to Proposed Regulation Best Interest ("Regulation BI"); File Number S7-07-18

Dear Secretary Fields:

Thank you for the opportunity to share our comments on proposed Regulation BI. Pacific Life Insurance Company ("Pacific Life") commends the Securities and Exchange Commission ("SEC") for developing a sensible rule governing broker-dealer conduct that retains a neutral approach to business models, operations, compensation, and products. We respectfully offer the comments below to assist the SEC in determining how to best implement standards of conduct for investment advisers and broker-dealers (together "financial professionals") in order to strengthen retirement security for American consumers. With certain changes proposed by Pacific Life and others within the industry, we feel that the SEC (while working with other regulatory agencies) can achieve our shared goal of having a clear, consistent and well-defined uniform best interest standard of conduct.

Support for a Reasonable and Uniform Best Interest Standard of Conduct

Pacific Life is committed to acting in the best interest of our customers and supports the enactment of a reasonable and uniform standard of conduct for all financial professionals that preserves consumer access to and choice of advice models and retirement products.

Reasonable

As an industry, we need to find a balance between regulating practices that may harm consumers and over-regulating. Over-regulation may cause financial professionals to refrain from offering certain products/investments to consumers and eliminate consumer access to financial advice at a time when they need it most – whether beginning to save and invest, focusing on their growing family's needs, planning for retirement, or in retirement. Ultimately, an environment that is over-regulated will lead to fewer options for consumers and eliminate more favorable pricing that innovation and competition brings to the market.

Uniformity to Reduce Consumer Confusion

Pacific Life senses that, despite the SEC's efforts, consumer confusion will remain if there are varying standards of conduct that apply for different financial professionals. In fact, the SEC has shared this concern, as pointed out in a prior study, that "[m]any investors are also confused by the different standards of [conduct] that apply to investment advisers and broker-dealers… [this] confusion has been a source of concern for regulators and Congress."[1]

We have noted that consumer surveys around this topic were typically worded awkwardly. Consumers were asked something like "Would you rather work with a financial professional who is *required* to act in your best interest, or *merely* sell you suitable products." Of course, the overwhelming majority said they would rather work with a financial professional that acts in their best interest. This survey question was then interpreted by certain industry and consumer groups to mean conclusively that consumers prefer to work with a fiduciary. Is that what consumers were asked or what they said? Did consumers truly say they preferred to work with a "fiduciary"? What if a consumer were asked instead – "Would you rather work with a financial professional who acts in your best interest or with a fiduciary?" Consumers will almost certainly say "best interest" because these plain words are more understandable to a non-professional. The average consumer does not understand the legal distinctions between what a "fiduciary" is or does, and what a broker-dealer/associated person does differently in a "suitability" review. A consumer would certainly understand that their financial professional must act in their best interest, regardless of what the professional is called. Thus, a uniform standard of conduct should move away from labels and terms consumers cannot comprehend such as "fiduciary" or "suitability".

Consumers Need a Uniform Plain English Standard of Conduct

No matter who sits across the table from the consumer, all financial professionals should be required to act in the best interest of the consumer. A consumer should never be put in the position to discern, understand, or identify the "standard of conduct" that is required of a particular financial professional. A typical consumer will not fully appreciate the differences between a "fiduciary" and "suitability" standard, or any multiple versions of either, even when explained. As an industry, we need to be more clear and concise in what roles and responsibilities investment advisers and broker-dealers have in their clients' financial planning, and it all should start with a uniform standard of conduct that consumers can comprehend and apply to all dealings they have with their financial professional.

[1] U.S. Securities and Exchange Commission. "Study on Investment Advisers and Broker-Dealers." January 2011.

Appendix A shows the difficulty consumers and financial professionals have when dealing with multiple standards of conduct. In order to provide a holistic consumer experience, the vast majority of financial professionals wear several hats and sell various types of products with different compensation models. Appendix A illustrates the scenario where Sally Smith, a consumer, asks John Doe, a financial professional affiliated with or through different entities as indicated in the diagram, whether he is a fiduciary (as the consumer groups strongly recommend Sally should ask). How does the SEC propose John Doe answer this question since, under the current framework, it depends on what hat John Doe is wearing at what point in the conversation or relationship with Sally Smith? The only reasonable way to truly avoid consumer confusion in this scenario is for the financial professional to always act in the consumer's best interest (and defined the same across the board), regardless of which hat they are wearing.

If the goal, often articulated by Chairman Clayton, is to truly end consumer confusion, all financial professionals, whatever they call themselves or who regulates them – investment advisors, brokers, insurance producers, financial planners, or anyone else holding themselves out as proficient in providing financial advice to a retail consumer – must act *the same* in meeting the consumer's best interest obligation.

Uniformity Across Regulators

Another element needed to end consumer confusion in financial planning requires all prudential federal and state regulators with oversight over any financial professionals to reach an agreement that all financial professionals subject to their jurisdiction must act in the consumer's best interest. This necessitates a uniform best interest standard of conduct with uniform core elements that consumers can easily understand and is applicable to all financial professionals.

Appendix B is a chart that depicts a framework that includes the core elements of what a Uniform Best Interest Standard of Conduct could look like; almost all reflected in Regulation BI. The flowchart on the left side shows the "above the line" framework of the why, the what, and the who. The right-hand side includes core common elements of a Uniform Best Interest Standard of Conduct that would be applicable within the spirit of the different regulatory structures, including:

- Common uniform best interest themes and definitions
- Common disclosure requirements
- Common guiding elements

Then, each prudential regulator has the ability "below the line" to establish the rules in their respective space to support these uniform standards. This consistency will make it easier for consumers as they would not need to know the intricacies of any rules applicable to that investment advisor, broker, or insurance producer other than to know they all would act in their best interest within this framework. But, the financial professionals would know how these

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requirements are to be met based on rules and regulations applicable to them, and be held accountable by their respective regulators.

Distinctions Between Advisors and Brokers after Regulation BI can be Disclosed

The SEC has taken an important and leading step toward harmonization of a best interest standard of conduct in financial professional interactions with consumers through Regulation BI. There are still differences between a broker-dealer/associated person and a registered investment advisor fiduciary, as there should be, but not at the point of contact with a consumer.

Two important differences will remain and will be resolved through required disclosure that will make these differences easier to decipher for consumers when determining the roles and responsibilities of a financial professional. First, interaction with a broker-dealer/associated person is transactional, focused solely on the current recommendation, whereas, an investment advisor's fiduciary obligations require ongoing monitoring and evaluation of the consumer's investments. This can be addressed in disclosure of the scope of the financial professional's relationship with the consumer. Another difference lies in compensation, also a required disclosure item, and compensation varies depending on if there is a single transaction or ongoing responsibilities. Neither of these differences, Pacific Life would contend, changes the same uniform standard of conduct that a broker-dealer/associated person and an investment adviser owe to the consumer.

The Uniform Standard of Conduct Should Remain Compensation Neutral

Standards of conduct when interacting with a consumer should not shift based on how the financial professional is to be compensated. No one compensation method is somehow better than another, or makes the financial professionals' duties to the consumer any different, nor completely conflict free. No matter how a financial professional is compensated (e.g., flat fee, ongoing percentage fees, commission, hourly, etc.), the professional must act in the same best interest of the consumer. Most importantly, required compensation disclosure paired with the required explanation of the different levels of services (e.g., what services are provided, and how will the financial professional be compensated for these services) will lead consumers to better evaluate if the products and services will meet their needs.

Too much has been made of how commissions influence a financial professional's recommendation to the detriment of the consumer (e.g., conflicted advice). Appendix C shows a mathematical example in table and chart forms. All things being neutral, a one-time 4.5% commission compensates a broker-dealer/associated person more than an investment advisor will earn with a 1.5% fee for assets under management in the first year. However, the analysis does not end there. Over time (in this example a 12-year period), a consumer will be better off with a commission-based recommendation rather than the ongoing fee drag of annual advisor fees. Further, over time, a dually registered financial professional (and most registered investment advisers are also broker-dealers/associated persons) will make substantially more money on a fee basis than with a commission on a single transaction. Time is a critical element to judging

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overall performance for both the consumer and the financial professional; making distinctions for the services rendered and the time frame for the services rendered are *never* mentioned in a disparaging conflicted advice statement.

This is simply math but, of course, the real-world analysis is more involved than that. As we already stated, a broker-dealer/associated person is paid for a single transaction and an investment advisor is paid for ongoing services. The ultimate decision of which path to take should be based on the needs and desires of the consumer. But, you would not appreciate these distinctions if you merely follow the rhetoric that has weaponized mere receipt of commissions as somehow equal to providing bad advice. For an example of this rhetoric, you can simply look to the latest ad from the *Institute for the Fiduciary Standard*:

What is usually left out of the "highest standard" or "intimate" fiduciary story is that most Americans do not have enough investable assets to open an advisory account, or can't afford the annual fees, and what does the consumer do then? What choices remain? Where does the consumer turn for advice?

Brokers and advisors are compensated differently because the services they provide to the consumer are different, and both the scope of the services to be provided and the method of compensation should be disclosed to the consumer so a consumer can make an informed decision. However, no matter how the financial professional is paid, they must act in the same best interest of the consumer. Standards of conduct should not turn on how a financial professional is compensated and must be compensation neutral.

<u>Complying with a Uniform Standard of Conduct</u>

While consumers need plain English terminology and concepts, the financial industry needs precision and specificity so that it may adequately comply with the standards of conduct. This will also allow the SEC and other prudential regulators to properly apply these standards in an equitable manner. Set forth below are some examples intended to illustrate Pacific Life's concerns.

Prudent Person

Pacific Life expects the SEC will receive comments pushing the SEC to adopt the recently vacated Department of Labor's ("DOL") Impartial Conduct Standards definition of "best interest" that included a prudent person standard. We would support the SEC's decision to leave the prudent person standard out of Regulation BI for the following reasons.

The "prudent person" standard is a concept included in the proposed DOL Fiduciary Rule ("DOL Rule"), existing ERISA fiduciary interpretations, or other common law fiduciary principles. One of the issues with using this principles-based terminology is that a determination of whether the prudent person standard was met is made in a court of law after a thorough and typically lengthy evidentiary hearing. Currently, not even registered investment adviser fiduciaries are held to a similar prudent person standard. Broker dealer/associated person behavior is "rule-based" and dictated primarily through the Financial Industry Regulatory Authority ("FINRA") rules, guidance, and supervisory and oversight structures. It is impractical (and costly) to build into a supervisory structure a need to "litigate" every recommendation made by a financial professional and reviewed and processed through their broker-dealer to determine if a financial professional met the "prudent person standard" as to that particular recommendation and consumer.

In line with the goal to have clear and well-defined legal standards within Regulation BI that will result in consistent, predictable outcomes, we do not see the value of including the highly subjective prudent person standard as proposed by the DOL when Regulation BI itself identifies specific objective measures (e.g., well stated "Duties of Care") for a financial professional to meet, those that review their activities to apply, and the regulators to enforce, without resorting to litigation at every turn.

Care, Skill, Prudence, and Diligence

It is unclear whether the SEC should or will determine when a financial professional is acting with "care, skill, prudence, and diligence," or whether the SEC will leave this to FINRA to provide guidance. Either way, financial professionals will need guidance as to how to meet these requirements, otherwise, it will be left to the courts; and this is not a workable solution for the same reasons stated above about the prudent person standard. In fact, as we saw with the DOL Rule, lack of clarity, or fear of unknown legal and regulatory risk, led to regulatory arbitrage where financial professionals gravitated to more defined, less legally risky choices (or more personally financially rewarding to offset the legal risks and compliance costs). Even though the DOL Rule was vacated, specific distribution partners of Pacific Life have continued to scale back the retirement products they offer, limiting competition and consumer choice, and will continue to do so if regulatory agencies continue to propose or implement unreasonable and unclear regulations. Financial professionals associated with such partners plan to be more selective of the new consumers they choose to service (i.e., those with higher amounts of assets

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to invest) which will limit access to retirement information and personalized advice for most Americans. In preparation of complying with the DOL Rule, distributors had identified and eliminated existing clients with small to modest account balances in anticipation of the added compliance costs and heightened litigation risks generated by compliance with the DOL Rule. Thus, the SEC must be careful in crafting a regulation that can stand on its own in application and enforcement, otherwise a significant number of consumers could lose access to financial professionals to talk to, answer questions, and who can help encourage them to save more and remain invested over time.

To avoid industry doubt or confusion as to what the SEC intended by these terms and how each term can be satisfied by the financial professional, Pacific Life recommends that the SEC either (i) provide a clear, concise definition of each of these terms and how they can be met within Regulation BI or (ii) provide FINRA with sufficient guidance and instruction as to how to define these terms either directly or within the context of existing FINRA Rules.

Longevity Should be Considered in Suitability Review

Lastly, a concern shared by many within our industry is that the unintended consequences of new regulations that unevenly impact recommendations of a particular product will steer financial professionals away from recommending certain products. Annuities are clearly one of the most regulated financial products available in the marketplace. The fear is that some financial professionals may only recommend products that have the least number of hurdles to contend with (i.e., have minimal licensing, training and supervision requirements and therefore the least complicated review and sales process). This creates a situation where certain products, such as annuities, are not even brought to the table for the client to consider even if including those products in their financial portfolio would be in their best interest. This could be detrimental to many Americans saving for retirement since annuities are the only products available on the market to offer guaranteed lifetime income at a time where employer-offered pension plans and other sources of guaranteed income (e.g., Social Security) are either lacking or maintain an uncertain future. Saving for retirement, and greater access to viable solutions (such as annuities) is an important focus of many Congressional leaders who want to help Americans understand the importance of considering converting a portion of their current savings into what would equate to lifetime income (the equivalent of unavailable defined benefit plans). It would be unfortunate if an unintended consequence of SEC regulation is to reduce the availability of annuities to needing consumers.

A possible solution is adding "longevity risk and need for guaranteed lifetime income" to the definition of the *Retail Customer Investment Profile* as an important factor to consider and discuss with the consumer during the Duty of Care review process. We anticipate that this would require coordination with FINRA, but discussing the need for and sources of lifetime income would make sense for any financial professional acting in their client's best interest. This would keep product recommendations, such as annuities, in the mix to help ensure retirees do not outlive their accumulated assets.

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Conclusion

Pacific Life appreciates the SEC's desire to ensure that American consumers are receiving advice in their best interest. For the reasons stated above, Pacific Life supports solutions to reach this level of consumer protection, while at the same time reducing consumer confusion and providing clarity to consumers in their dealings with financial professionals.

Pacific Life supports coordinated efforts among the functional regulators to develop uniform standards of conduct that can be consistently applied across all regulatory platforms. Most importantly, such coordination will help ensure that consumers are not asked to identify or be responsible for understanding what standard of conduct, from a multitude of possible standards, any particular financial product sale or investment/financial advice is under.

Pacific Life joins the American Council of Life Insurers, the Committee of Annuity Insurers, and the Insured Retirement Institute in supporting a full and comprehensive review of the Rule. In order for us to achieve our shared goal for American consumers to save for a secure retirement, and receive advice that is in their best interest, we firmly believe it is in everyone's best interest to get Regulation BI and its implementation done correctly to minimize market disruption and ongoing consumer confusion.

Sincerely,

Sharon A Cheever

Sharon Cheever
Senior Vice President and
General Counsel

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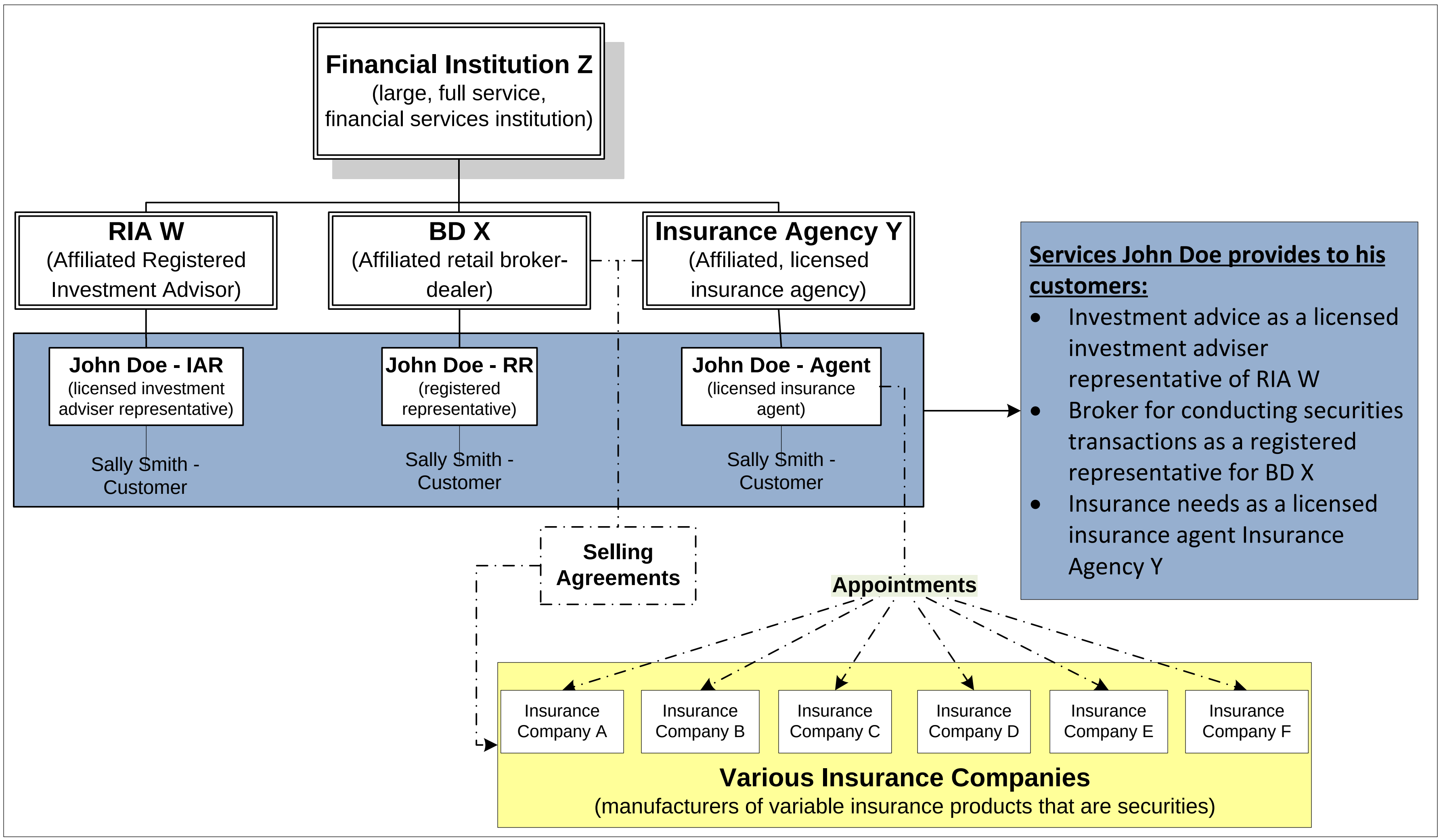
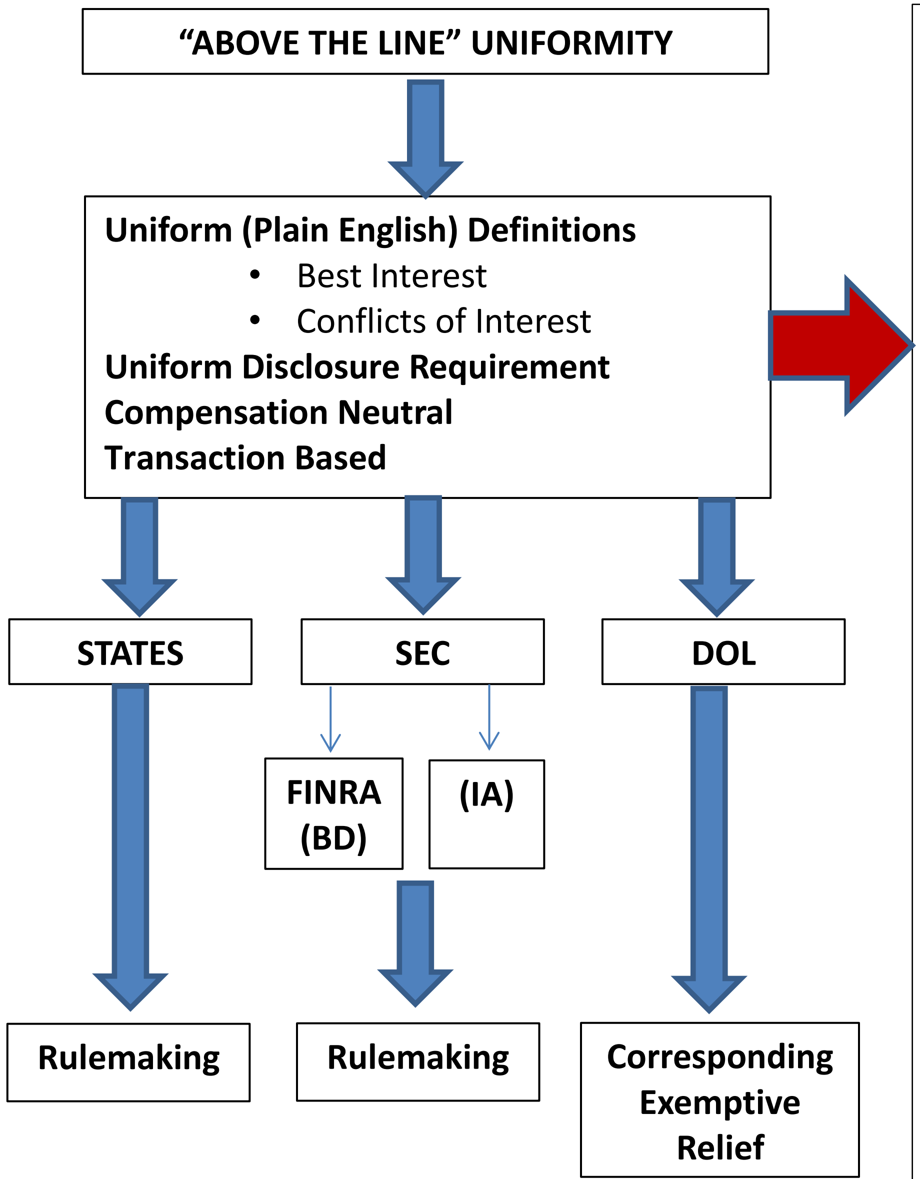
What Standard of Care Applies?

When John Doe engages with Sally Smith, what standard of care applies?



UNIFORM STANDARD OF CARE

Goal: Approved by Industry, Regulators, and Consumer Groups



Common Uniform Definitions:

A recommendation is in the "Best Interest" of the consumer when the financial professional:

- puts the consumer's interest first;
- acts with reasonable care, skill, prudence and diligence in gathering and evaluating the Consumer's Profile Information used to make the recommendation;
- makes no misleading statements;
- provides full disclosure of the recommended investment/insurance product's features, fees, and charges;
- fairly discloses how and by whom the financial professional will be compensated; and
- avoids, or discloses and manages Material Conflicts of Interest.

"Material Conflict of Interest" means a financial interest of the financial professional making a recommendation that a reasonable person would expect to affect the impartiality of such recommendation.

Common Disclosure Requirement:

Material Conflicts of Interest must be disclosed at or prior to the point of sale or at the time the recommendation is made (no requirement for more frequent or annual disclosures). This disclosure must include:

- the types and scope of services provided; and
- the types of compensation received by the person making the recommendation [or related party] or that the customer may pay as a result of the recommendation.

Common Guiding Elements:

Neutrality -- The uniform standard of care is neutral to business model, product type, and compensation approach such as commissions, fees, hourly rates, or sales charges, or other fees or variable compensation.

- The fact that an advisor or firm only offers or recommends proprietary or a limited range of products or product types or receives commissions or other variable compensation shall not be inconsistent with this uniform standard of care.

Conduct - The uniform standard of care applies to the conduct of the financial professional, not the recommended product, i.e., it does not require a recommendation of the least expensive or "best" product available.

Transaction Based – Unless otherwise agreed to in writing by the advisor and consumer, the uniform standard of care is a applies when a recommendation is made with no further ongoing obligations.

3/22/2018

ADVISOR COMPENSATION STRUCTURE'S IMPACT ON INVESTOR RETURNS AND ADVISOR COMPENSATION

	DATA/STATIC INVESTMENT RETURN (NO ADVISOR)	INVESTMENT LESS 1st YR. COMMISSION	INVESTMENT LESS COMMISSION (WITH TRAIL)	ANNUAL RETURN LESS ANNUAL MANAGEMENT FEE
Annual Earning Rate	6.00%	6.00%	5.75%	6.00%
1st Year Commission	4.50%	4.50%	4.50%	
Annual Trail Commission	0.25%		0.25%	
Management Fee	1.30%			1.30%
Number of Years	12	12	12	12
Lump Sum Investment	$100,000.00	$95,500.00	$95,500.00	$100,000.00
Investor Total Net Return	$201,219.65	$192,164.76	$186,796.13	$173,524.25
DIFFERENCE IN RETURNS:				
Commission vs. Fee Return		$18,640.51		
Commission (+Trails) vs. Fee Return			$13,271.88	
Compensation to Advisor:				
Commission Earned		$4,500.00	$9,868.63	
Advisor Fees				$27,695.40
Compensation Difference Commissions vs. Fee		($23,195.40)	($17,826.77)	

Assumptions:

1st Yr. Commission reduces amount of initial investment; Trail Commissions reduce Annual Return

Annual Fee reduces annual earnings rate (Fee paid out of Investment)

Total Fees Received difference between static investment and net of fees investment results

ADVISOR COMPENSATION STRUCTURE'S IMPACT ON INVESTOR RETURNS AND ADVISOR COMPENSATION

Assumptions:

Annual Earning Rate	6.00%
1st Year Commission	4.50%
Annual Trail Commission	0.25%
Management Fee	1.30%
Number of Years	12
Lump Sum Investment	$100,000.00