The Committee for the Fiduciary Standard

PO Box 3325
Falls Church, Virginia 22043

May 3, 2011

The Honorable Scott Garrett
Chairman
Subcommittee on Capital Markets & Government Sponsored Enterprises
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington D.C. 20515

RE: SEC Staff Study on Section 913 of Dodd-Frank Act

Dear Chairman Garrett:

This letter is in response to the March 17 letter to SEC Chairman Mary Schapiro from you and members of the Capital Markets Subcommittee regarding the SEC Staff study on Section 913 of the Dodd-Frank Act.

The Committee for the Fiduciary Standard * applauds you and members of the Subcommittee on Capital Markets & Government Sponsored Enterprises for planning a hearing in the near future to publically examine the research and analysis presently on the record regarding obligations of broker-dealers and investment advisers and the important questions that this issue raises. Our hope and expectation is that this process will help avoid further delay in implementing meaningful reforms to better protect retail investors.

In light of the importance of this issue and an upcoming hearing, the Committee for the Fiduciary Standard believes it is critical to add additional pertinent considerations that relate directly to the points raised in your letter to Chairman Schapiro.

The pros and cons of applying the fiduciary standard to broker-dealers when giving personalized investment advice about securities to retail clients have been studied extensively and this research should be examined. Additionally, the opportunities and limitations of using cost-benefit analysis to evaluate standards of conduct should also be considered.

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* The Committee for the fiduciary Standard is a group of investment professionals and fiduciary experts that formed in 2009 to advocate for the established fiduciary standard under the Advisers Act and the

Committee's five core fiduciary principles. For more information, see: www.thefiduciarystandard.org.

Justification for a Uniform Fiduciary Standard

The expressed concern that the SEC staff's recent study does not "adequately justify its recommendation" for applying the fiduciary standard to broker-dealers who provide personalized investment advice to retail clients appears to be based on the view that the study provided inadequate "articulation or substantiation of the problems" that the staff's recommendation would address. In addition, the concern appears to be based on a view that staff's report did not provide for adequate recognition of "the risk that its recommendations could adversely impact investors."

The Committee for the Fiduciary Standard agrees that there is a far larger knowledge base than the study, in and of itself, to consider. This is why we believe the study was directed, pursuant to Section 913, to address 14 specific issues identified by Congress, and was not conceived and deemed by Congress to be the *sole basis* upon which to determine whether the Commission should proceed with exercising its rulemaking authority to implement a uniform fiduciary standard. We believe the study was intended to be viewed within the larger context of the extensive body of knowledge of research, analysis, and commentary that exists today on the obligations of broker-dealers and investment advisers.

In 1995 SEC Chairman Arthur Levitt instigated the "Report of the Committee on Compensation Practices" (also known as the Tully Report, 1. for its chairman, Daniel P. Tully). Since then, the policy debate has continued and the body of available research and analysis has expanded. In February of last year, the Committee for the Fiduciary Standard provided Senate Banking Committee staff a brief summary analysis of how certain questions raised by the Senate Banking Committee were substantially or completely addressed in this existing extensive knowledge base. (See Attachment A.) 2.

One notable observation that can be drawn from this existing knowledge base is that there are commonly held views about the obligations of broker-dealers and investment advisers that are not seriously questioned by most industry participants today. Among those views: many retail investors are not well equipped to make investment decisions and do not understand the different roles of advisers and brokers, that investors often view the services of broker-dealers and investment advisers indistinguishably, that investors believe all investment advice should meet the fiduciary standard, that disclosures frequently do not have the effects on investor decision making that regulators intend , and that applying the fiduciary standard to all investment professionals who render personalized investment advice about securities to retail investors is good for investors.

At a more granular level, the impact of the 2008 "Rand Report" is noteworthy. Over the three years since that report was published, it has become a "de facto" encyclopedia of retail investing regulation: we are not aware of any instance where a credible organization has meaningfully disputed a major conclusion of the Rand Report. This affirms the degree of consensus on the numerous issues addressed in the report and the broader body of knowledge.

Apply Rigorous Analysis To All Evidence and Data

As noted above, we welcome rigorous analysis of research, data, and differing views on this subject. It appears that one of the challenges SEC staff has faced in analyzing certain comments is the paucity of quantitative data provided to support differing views. For example, a review of the "point, counter-points" discussion provided on the topic of proceeding with a uniform standard, and the section addressing "Costs to Retail Investors, Including Loss of Investor Choice" in the SEC staff's study is illustrative. [3]

The staff's study recounts comment letters suggesting a new uniform standard "might significantly increase costs for broker-dealers, which would then be passed on to retail investors, ….. some commenters indicated that litigation would increase…. [and this would] increase the cost of insurance for the firm," however, the study notes, "*None of the commenters provided any quantification of such anticipated costs"* (emphasis added.) Further the study notes, "Commenters speculated" increased costs would cause many broker-dealers to stop offering certain products; while other commenters countered "the costs and impact on investor choice would be de minimis."

Further, the staff's study, as it deals with "potential costs" to retail investors of a harmonized standard, noted, "Commenters generally did not address whether or how additional harmonization of the broker-dealer and investment adviser regulatory regimes would impact investor choice." The study summarizes, "Generally, commenters did not quantify particular costs or even give a range of costs they would incur for various potential outcomes." Interestingly, the study does not mention in this discussion that one group provided a presentation analysis that purportedly provided particular costs. [4]

Cost Are Always Business Concerns

Costs are always a concern of businesses as they should be. However, in this instance as reflected in the record, commenters limited themselves to expressing "concerns," and, chose not to provide data to support their concerns. This distinction is significant. In and of itself, based on this record provided by industry commenters, it is not at all clear there are material incremental costs directly associated to the fiduciary standard.

However, even if the record provided strong and persuasive evidence in the form of independent and credible research that applying the fiduciary standard would add incremental costs to broker-dealers, it is certainly not clear how such evidence ought to be weighed. The task of weighing the "cost concerns" against the "benefits" of brokers putting their customers' best interests first presents a dilemma. The mission of the U.S. Securities and Exchange Commission is "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." A cornerstone of the SEC's mission is investor protection. The discussion in the SEC staff's study comparing the fiduciary and suitability standards is pertinent. [5]

The Commission has stated that the fiduciary duty of investment advisers includes a duty of loyalty and duty of care … with the duty of loyalty requiring investment advisers to act in the best interest of clients and to avoid or disclose conflicts. The standard of conduct for broker-dealers has been characterized as primarily to deal fairly with customers…. In practice, with broker-dealers, required disclosures have been more limited than with advisers and apply at different points in the customer relationship.

The staff believes that these differences in the standard of conduct are significant and not well understood by retail customers, as the RAND Report and many commenters observed.

How should the SEC weigh the acknowledged benefits of the higher standard of putting investors' interests first (a standard that the staff agrees provides a "significant" difference in investor protection) as compared to the standard applied to broker-dealers, against the industry's "concerns of costs"?

If there were an actual incremental cost (a cost that is not offset by a cost-savings elsewhere) to firms directly associated with practices and procedures required to place investors' interests ahead of the firm or its representatives, should this incremental cost, hypothetically, be presumed to be reasonable? At what point does the Commission determine such a hypothetical cost becomes unreasonable or too high? At what point and on what basis does the Commission determine that adhering to the duties of loyalty and care is "too costly" for the industry and, in so doing, effectively, decree these fiduciary duties null and void? Even contemplating such a scenario would seem to put into question the rationale of the anti-fraud provisions within the Advisers Act.

Policy makers should seek independent data, when available, to determine the feasibility and wisdom of proposed policies. We believe, in this case, that the record demonstrates significant consensus on the wisdom of raising the standard of conduct required of all investment professionals rendering personalized investment advice, a consensus supported by, in recent times, abundant research, analysis and data starting with the Tully Report in 1995 (as discussed above). We would gladly discuss this record with you. The Committee for the Fiduciary Standard is comprised of leaders in the advisory industry who are prepared to provide any assistance to your subcommittee as it addresses this critical issue.

Sincerely,

Knut A. Rostad

Knut A. Rostad
Chairman

Copies to:

Members of the Subcommittee on Capital Markets & Government Sponsored Enterprises, and

SEC Chairman Mary L. Schapiro
SEC Commissioner Luis A. Aguilar
SEC Commissioner Kathleen L. Casey
SEC Commissioner Troy Paredes
SEC Commissioner Elisse B. Walter

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Notes

1. http://www.sec.gov/news/studies/bkrcomp.txt

2. Analysis of Senator Tim Johnson's Proposed Study of Broker and Adviser Obligations, The Committee for the Fiduciary Standard, February 2010. http://thefiduciarystandard.org/images/Analysis_of_Johnson_Provision_FINAL__2__03_05_10.pdf

3. Study on Investment Advisers and Broker Dealers, see page 159.

4. The Oliver Wyman / SIFMA presentation had suggested cost impacts of the uniform standard on its member firm customers. Analysis was offered in this presentation from SIFMA members that it is claimed suggests fee-base accounts are more costly to investors than are brokerage accounts. However, due to the lack of access to the underlying data itself, it is not possible to independently analyze the study data and draw conclusions about how it should be interpreted. Also, it should be noted here that both SEC and EBSA staff have requested SIFMA to provide the underlying data such that the presentation could be independently assessed. To date, to our knowledge, the underlying data has not been provided by SIFMA.

5. See discussion beginning on page 106.