July 5, 2013

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Duties of Brokers, Dealers, and Investment Advisers; SEC Release No. 34-69013; File No. 4-606 (Request for data and other information)

Dear Ms. Murphy:

Better Markets, Inc.[1] appreciates the opportunity to comment on the request captioned above ("Request"). In the Request, the Commission seeks "data and other information" regarding the potential costs and benefits associated with the imposition of various standards of conduct for broker-dealers ("brokers") and investment advisers ("IAs") when they provide personalized investment advice to retail customers.

The Request indicates that the Commission will use the resulting input to determine whether to engage in rulemaking under Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) ("Dodd-Frank Act"), and if so, precisely what standard to impose. Section 913 authorized the Commission to promulgate a rule establishing a uniform fiduciary standard of conduct for all brokers and IAs providing personalized investment advice about securities.

The real issue underlying this Request is whether the SEC is finally going to give all investors the protection they deserve when they receive investment advice about securities from brokers, or whether the agency will continue to allow the brokerage industry to reap the benefits of a double regulatory standard—one that has no justification—at the expense of their clients. This is an issue that should have been addressed long ago, since by virtue of plain logic, endless studies, and decades of experience under the Investment Advisers Act of 1940 ("Advisers Act"), the need to apply a fiduciary duty equally to brokers and IAs dispensing advisory services has been obvious for years.

Although the Request is not a rule proposal, it is a step towards accomplishing one of the SEC's most important and long overdue regulatory reforms: finally ensuring

[1] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

that any financial industry participant providing securities advice to a client, regardless of whether they are a broker or an IA, is subject to a fiduciary duty. The SEC should proceed without delay to issue a rule imposing the strongest possible uniform fiduciary duty on brokers and IAs when they provide investment advice to clients about securities.

SUMMARY OF COMMENTS

- A rule imposing the fiduciary duty on brokers providing investment advice to clients is long overdue, and the SEC should act as quickly as possible to close this regulatory gap. Brokers have exploited the IA registration exemption under the Advisers Act for years, flaunting the letter and spirit of the law with impunity. In the world of finance, all investors need to be protected from potential abuse at the hands of those providing advice, and the application of the fiduciary duty is the only way to afford adequate protections.

- The Request seeking "data and other information" is an unfortunate diversion. Logic, common sense, a long series of studies, and decades of experience applying the fiduciary duty under the Advisers Act have all made it abundantly clear that anyone providing advice about securities to clients should be subject to the fiduciary duty, regardless of their registration status or business model. The SEC's own study conducted pursuant to Section 913 of the Dodd-Frank Act reached this conclusion in January of 2011.

- The SEC should propose a rule applying the strongest possible uniform fiduciary standard on brokers as well as IAs within the boundaries set forth in the Dodd-Frank Act and should narrowly apply any exceptions permitted by the statute.

    - The final "fiduciary duty" adopted by the SEC must be a fiduciary duty in fact. This means that the Commission cannot pick and choose different obligations to impose on brokers and IAs and then misleadingly call them a "fiduciary duty." Rather, the SEC must start off with a minimum true fiduciary duty, as it has evolved through judicial and agency interpretations, and then apply further measures as necessary and appropriate to protect investors, consistent with the Dodd-Frank Act.

    - Disclosure and consent are not sufficient. Far from being a true fiduciary duty, a disclosure regime by itself is little more than a slightly modified version of "buyer beware." Disclosures can easily be designed to obscure the real significance of an adviser's conflict of interest, and consent can easily be extracted from clients who remain utterly bewildered and confused about what they are really consenting to, or worse, falsely comforted. The new standard must ensure that even after full disclosure of any conflict, the adviser must at all times act in the best interest of the client.

- The fiduciary duty should extend to more than just retail customers. Section 913 of the Dodd-Frank Act expressly allows the SEC to extend the protections of the fiduciary duty beyond retail customers and to "such other customers as the Commission may by rule provide." Institutional investors also require the protections of the heightened standard of loyalty and care, especially where they lack the sophistication in financial matters that is often assumed but in reality absent.

- Allowing commissioned-based compensation and the sale of proprietary products should be subject to protective measures. The right to receive such commission-based compensation or to sell proprietary products, if permitted at all under the fiduciary standard, must be conditioned on measures designed to ensure that customers receive full, clear, and timely disclosure; that they understand and consent to those arrangements; and that, at all times, notwithstanding such consent, the customers' best interests comes first.

- The exception for a continuing duty of care must be limited. To address this potentially massive loophole, the SEC must ensure, for example, that brokers cannot resort to clauses in fine-print contracts that operate as a convenient "on-off switch" for the fiduciary duty. Instead, and at a minimum, a holistic facts and circumstances test must be developed so that the duty, once triggered, only ends in accordance with the client's well-informed understanding.

- The SEC should not be unduly influenced by pleas to protect and preserve the broker business model and the products and services they traditionally offer. If imposing the fiduciary duty on brokers, and requiring them to act in the best interest of investors, prevents them from offering their products and services, then at a fundamental level, those products and services are presumptively unworthy of preservation. In other words, the fiduciary duty must be applied to any broker providing investment advice to a client, and the brokers must adapt their models, products, and services to this new and higher standard of conduct.

- The SEC must construe "personalized investment advice" broadly. This too represents a potentially huge loophole in any new standard the SEC applies. In any guidance to be developed, the SEC should draw on one of the basic maxims of securities law and make clear that advice will be deemed personalized if it is personalized in substance and reality, regardless of form. Further, the SEC should not create "safe harbors" for ostensibly "generalized" advice, since virtually any form of advice, no matter how generalized on its face, can be deployed in a way to influence a client or prospective client and steer them toward specific investments.

- The Request illustrates the debilitating impact that cost-benefit analysis is having on the SEC's ability to promulgate rules necessary to protect investors.

Apparently motivated by a desire to head off a legal challenge to any fiduciary duty rule it promulgates, the Request is causing harmful delay in achieving a clearly necessary and important objective: applying the fiduciary duty to protect all investors who receive advice about securities. Moreover, the Request highlights the insurmountable challenge of attempting to catalogue and quantify all the costs and benefits of such a rule.

- As it formulates its fiduciary duty rule, the SEC should adhere to a number of core principles governing the economic analysis actually required under the securities laws.
    - Under the securities laws, the SEC has no statutory duty to conduct cost-benefit analysis; in fact, its far more limited obligation is simply to consider certain enumerated factors.
    - The SEC must be guided above all by the public interest and the protection of investors as it considers the economic impact of its rules, not by concerns over the costs of regulation imposed on industry.
    - For any rule promulgated in accordance with and in furtherance of the Dodd-Frank Act, the ultimate public interest and investor protection consideration is implementing the reforms that Congress passed to provide for a safer and sounder financial system and to prevent another financial crisis.
- A rule applying the fiduciary duty to brokers under Section 913 of the Dodd-Frank Act will satisfy the limited economic analysis test that applies.
    - First and foremost, such a rule will protect investors from conflicts of interest and other forms of abuse at the hands of brokers subject to weaker standards than IAs.
    - Second, the rule will promote efficiency by ensuring that more of each investor's funds can be devoted to sound investments, rather than wasted on unnecessary fees, charges, and securities products that increase a broker's profits at the expense of their clients.
    - Third, the rule will promote fair competition by correcting a gross disparity in the regulatory treatment of brokers and IAs when they are performing the same function.
    - Fourth, the rule will promote increased capital formation by raising investor confidence in the securities markets and the firms that provide advice.
    - Finally, by raising the standard of care applicable to brokers who advise clients—including at a minimum the institutional clients discussed above—about investing in securities, the rule will also help further the

overarching goals of the Dodd-Frank Act: promoting accountability in the financial system and limiting systemic risk.

COMMENTS

I. A rule imposing the fiduciary duty on brokers dispensing investment advice to clients is long overdue, and the SEC should act as quickly as possible to close this regulatory gap.

The disparity in the regulatory treatment of brokers and IAs that provide advice about securities to clients is an indefensible gap in securities regulation, and the SEC should act without delay to correct it. Investors have waited far too long for the SEC to rectify this regulatory imbalance.

For years, the brokerage industry has stretched the registration exemption in the Advisers Act beyond all recognizable limits. Everything, from their advertising campaigns to their business cards, is designed to entice investors with the promise of trustworthy advice about investing in securities from a representative who supposedly has the client's best interest at heart.

The SEC has allowed brokers not only to foster this erroneous image, but to deliver virtually unlimited investment advice about securities to their clients without registration or regulation as IAs or the application of a fiduciary duty. This approach has been based on the mistaken notion that brokers' advice to clients is either "solely incidental" to their brokering activity or that they receive no "special compensation" for that advice. These antiquated notions no longer reflect reality.

Long ago, the SEC could have and should have narrowly interpreted the statutory exemption and forced all broker-dealers acting as IAs to register as such under the Advisers Act. *See* 15 U.S.C. §80b-2(a)(11). Instead, and remarkably, the SEC actually attempted to expand the exemption by issuing a rule that effectively wrote the "special compensation" test out of the statute. *See* Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 34-51523, 70 Fed. Reg. 240424-01 (Apr. 19, 2005); *see also Financial Planning Association v. SE*C, 482 F. 3d 481 (D.C. Cir. 2007) (invalidating the SEC rule allowing brokers to offer fee-based accounts and still enjoy the exemption from registration as an IA).

In fact, with certain limited exceptions such as discretionary accounts, the millions of investors who receive investment advice from a broker rather than an IA **do not receive** the protections afforded by the fiduciary duty. The deleterious impact on investors has been enormous and incalculable. And, the failure to apply the fiduciary duty more broadly to advisory activity has exacerbated systemic risk as well. For example, two essential ingredients of the financial crisis were toxic mortgage-backed securities stocked with subprime loans and credit default swaps written on those securities. Had all of the firms advising clients to buy those securities and enter those derivatives transactions been subject to a fiduciary duty and an obligation to place their clients' interests first, then the financial crisis might have played out very differently.

The securities, and derivatives linked to them, might never have been so widely disseminated; the raw material that fueled the crisis might have been much less plentiful; and the end result might have been much less damaging.

The Dodd-Frank Act clearly reflects this perspective. Congress recognized the need to impose a heightened standard of care in the derivatives markets, in part to better protect vulnerable institutional investors, but also to address the ever-present threat of systemic risk lurking in those markets: In addition to Section 913, the Dodd-Frank Act contains a provision requiring swap and security-based swap dealers to observe a "best interest" standard when acting as an adviser to any "special entity," such as a municipality or pension fund. *See* Dodd-Frank Act Sec. 764(a) (adding Section 15F(h)(4)(B) to the Exchange Act).

The regulatory imbalance between the duties of brokers and IAs has persisted for many years, even as the issue has been relentlessly studied. Almost a **decade** ago, the SEC commissioned a 2004 "focus group" to determine "how investors differentiate the roles, legal obligations, and compensation between investment advisers and broker-dealers." *See* SEC 913 Study at 95. That was followed in 2006 by the RAND study focusing on similar issues. *Id*. at 96. More recently, the SEC conducted the study mandated by Section 913 of the Dodd-Frank Act, to examine a broad set of issues all related to the disparate regulatory treatment of brokers and IAs that furnish advice about securities to customers.

The conclusions drawn in these studies support the immediate imposition of a uniform fiduciary duty upon both brokers and IAs that advise clients about securities. The studies make clear that closing the loophole is necessary not only to help eliminate the widespread confusion among investors about the standards of conduct to which they are entitled, but much more importantly, to actually ensure that all investors—whether confused or not—receive an appropriate standard of loyalty and care from their brokers.[2]

---

[2] The debate over the standards of loyalty and care that should apply to brokers and IAs alike is often dominated by a discussion about the high degree of investor confusion on the topic. Although eliminating that confusion is an important aspect of applying the fiduciary duty to brokers, it should not be viewed as the driving force. The real issue is whether investors need protection under the higher standard, regardless of their level of understanding or confusion about the legal distinctions. The debate is fundamentally about investor protection, not investor education. Thus, any claim that applying the fiduciary duty to brokers is unnecessary absent proof that investors remain confused is patently wrong and should be rejected. That line of reasoning is as flawed as the notion that legislators shouldn't pass laws protecting citizens from any number of crimes unless and until it is shown that average citizens are confused about the elements of each offense.

II. The Request seeking "data and other information" is an unnecessary and unfortunate diversion.

Further collection and analysis of data regarding the possible duties that the SEC could conceivably impose on brokers and IAs with respect to their advisory services is entirely unnecessary as a prerequisite for rulemaking. First, the justification for imposing a fiduciary duty on any firm providing advice about securities is self-evident. It is a matter of inescapable logic. No more data is required to know that two firms engaged in exactly the same activity—providing securities advice to clients—should be subject to the same legal duty of loyalty and care, regardless of their business model or registration status. Nor is more data or analysis required to determine the nature of that duty, since the Dodd-Frank Act provides parameters, and a large body of case law and guidance has evolved over decades under the Advisers Act, which fills out the contours of the fiduciary duty. *See SEC v. Capital Gains Research Bureau, Inc*., 375 U.S. 180, 194 (1963).

Some of the most compelling support for applying the fiduciary duty to brokers already exists in the SEC's most recent study, released in a 200-page report in January of 2011. In accordance with the statutory mandate in Section 913 of the Dodd-Frank Act, the SEC extensively evaluated two core issues: (1) the effectiveness of existing legal or regulatory standards of care for brokers and IAs providing personalized investment advice and recommendation about securities to retail customers; and (2) whether there are legal or regulatory gaps or overlaps in those standards. In conducting the study, and as required under Section 913, the SEC considered a long list of specific factors, including whether retail investors are confused about the applicable standards of care, the potential impact on retail customers of imposing a fiduciary duty on brokers, and the effect of adopting alternative measures, such as eliminating the broker exclusion from the definition of "investment adviser" in the Advisers Act.

The primary and unequivocal recommendation in the Study is that the SEC **"should engage in rulemaking to implement the uniform fiduciary standard of conduct for broker-dealers and investment advisers,"** and that such standard should be "**to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.**" SEC 913 Study at 108-09. The Study further recommends that the fiduciary standard be "**no less stringent than currently applied to investment advisers under the Advisers Act**," *Id.* at 108, and that the "**existing guidance and precedent under the Advisers Act regarding fiduciary duty**" should continue to apply. *Id.* at 112.

On a more pragmatic level, the justification for imposing the fiduciary duty on brokers is equally clear. Securities investments—even the familiar and ostensibly simple ones like mutual fund shares—are often complicated products in terms of their costs, fees, risks, returns, and profitability for brokers. Investors require trustworthy and competent advice when deciding which securities investments to make. However, for investors to receive such advice, their advisors cannot operate with economic incentives that create conflicts of interest. When brokers lack a fiduciary duty to buyers,

they have a greater incentive to give advice that maximizes broker income, regardless of the impact on the investor. Imposition of a fiduciary duty will serve to align the economic interests of brokers more closely with those of the investors from whom they make their living.

The Advisers Act and the case law interpreting that statute embody this very point: Investors must be able to trust that their advisers will act in their best interests, not the adviser's. In essence, Congress and the courts determined long ago that those who advise others about securities should be subject to the highest possible standard of loyalty and care. Viewed from another common sense perspective, other than industry self-interest, what possible justification could there be for **not** insisting that brokers, in addition to IAs, only give advice that serves their clients' best interests? None.

Indeed, in the recent case *Thomas v. Metropolitan Life Insurance Co.*, the court recognized the inherent contradiction in applying a fiduciary duty to investment advisers while exempting brokers from that duty. *Thomas v. Metro. Life Ins. Co.*, No. CIV-07-0121-F, 2009 U.S. Dist. LEXIS 78014 (W.D. Okla. Aug. 31, 2009). The case involved a broker's conflict-of-interest arising from his sale of proprietary products without any disclosure and to the detriment of the plaintiff investors. Although the court dismissed the breach of fiduciary duty claim, it noted:

> Any salesman worth his salt can convey the reassuring impression that his recommendations are based on his unbiased evaluation of his prospect's needs. Where the product being sold is a sophisticated financial product, as the [Plaintiffs'] variable life insurance policy surely was, it would seem that the need for unbiased advice—or at least for the disclosure of those things that might tend to skew the salesman's "advice"—would seem to be every bit as great as in a conventional advisory relationship.

Notwithstanding all of this logic, common sense, and history, including decades of experience under the Adviser's Act, endless studies, and Congress's explicit grant of rulemaking authority in the Dodd-Frank Act, the SEC has still failed to pass a rule that is so obviously necessary. Particularly in light of the recommendations in the Section 913 Study, the far more efficient and expeditious approach would have been to move forward with a rule proposal and seek comment and data relating to that proposal, rather than seeking yet more data and other information on the dizzying array of hypothetical scenarios described in the Request.

In short, the Request is a regrettable and unnecessary diversion of SEC time and resources away from the obvious task at hand: holding brokers to the same robust standards as IAs when they advise clients about securities. Logic, experience, and the mountains of evidence accumulated by the SEC over the years mandate this step.

III. The SEC should propose a rule applying the strongest possible uniform fiduciary standard to brokers and IAs within the boundaries set forth in the Dodd-Frank Act and should narrowly interpret any exceptions permitted by the statute.

The SEC should take full advantage of the authority conferred by Section 913 of the Dodd-Frank Act and propose the strongest possible uniform fiduciary standard for brokers and IAs that provide investment advice about securities to customers. As provided for in the Dodd-Frank Act, and as recommended by the SEC's own study under Section 913, that standard should be—

> "to act in the best interest of the customer, without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice."

Furthermore, that standard of conduct must be "no less stringent than the standard applicable to investment advisers under [the IAA] when providing personalized investment advice about securities." Thus, consistent with Section 913 of the Dodd-Frank Act, the uniform fiduciary duty should encompass a best interest standard and, as required by that Section, it must be no less stringent than the fiduciary duty in the Advisers Act, as interpreted by the courts and in prior SEC guidance.

Although the Dodd-Frank Act establishes some specific exceptions or limits regarding the nature and scope of the duty the SEC may impose, the SEC nevertheless retains enormous authority to ensure that the standard is only minimally weakened by those exceptions. The principal areas of concern are as follows:

1. The fiduciary duty must be a true "fiduciary duty." The uniform fiduciary duty adopted by the SEC must be a fiduciary duty **in fact** and have all the characteristics of such a duty.[3] These characteristics include, at a minimum, "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 [their] clients." *SEC v. Capital Gains Research Bureau, Inc*., 375 U.S. 180, 194 (1963) (citations and internal quotation marks omitted). To that end, the fiduciary must attentively serve the best interests of its clients by, for example:

   > "(1) manag[ing] the account in a manner directly comporting with the needs and objectives of the customer as stated in the authorization papers or as apparent from the customer's investment and trading history; (2) keep[ing] informed regarding the changes in the market which affect his customer's interest and act[ing] responsively to protect those interests; (3)

[3] Indeed, not including each of these elements in the uniform fiduciary duty standard has the potential to increase investor confusion, as it would conflict with long-established standards applicable to fiduciaries.

> keep[ing] his customer informed as to each completed transaction; and (5) explain[ing] forthrightly the practical impact and potential risks of the course of dealing [that] is [being] engaged [in]."[4]

2. Disclosure and consent is not sufficient. Section 913 of the Dodd-Frank Act specifies that under the authorized standard, all material conflicts of interest must be disclosed. However, the statute also provides that those conflicts "may be consented to by the customer." This language must not be read to imply that consent to a conflict of interest by a customer is sufficient to satisfy the fiduciary duty. A disclosure and consent regime, standing alone, is little more that "buyer beware." Rather, the rule must provide that at all times, even after a conflict of interest is disclosed, the broker or adviser must still observe the duty of loyalty and care and manage any conflict so that the interests of the customer always come first. Furthermore, nothing in this language prevents the SEC from flatly prohibiting certain conflicts of interest regardless of disclosure, where they pose too great a threat to a customer's best interest.

3. The fiduciary duty should extend to more than just retail customers. Section 913 authorizes the SEC to impose the fiduciary duty on brokers when they provide "investment advice to a **retail** customer about securities" (emphasis added). But it also states parenthetically that the SEC may extend the duty to "such other customers as the Commission may by rule provide." The SEC should invoke this authority to ensure that institutional investors also benefit from the fiduciary duty. Both institutional and retail investors are in need of the protections afforded by the fiduciary duty and, consistent with the Advisers Act, they should not be treated differently. At a minimum, institutional investors that are especially vulnerable, that lack sufficient financial sophistication, or that represent the interests of retail investors collectively (including, for example, pension funds) should also be protected. As discussed above, the Dodd-Frank Act reflects this very approach by requiring swap dealers and security-based swap dealers to adhere to a "best interest" standard when acting as an adviser to "special entities," including institutional investors such as municipalities and pension funds.

4. Commission-based compensation and sales of proprietary products should be conditioned on protective measures. Section 913 provides that the receipt of commission-based compensation or other standard forms of compensation for the sale of securities, and the sale of proprietary products, shall not, "in and of itself," be considered a violation of the standard. The "in and of itself" wording reflects Congress's intent that the SEC should take great care to ensure that these carve-outs remain narrow. Reinforcing the point, elsewhere in Section 913, Congress specifically required the SEC to

[4] *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp. 951, 953 (E.D. Mich. 1978) (describing the fiduciary duty of brokers handling discretionary accounts) (internal citations omitted).

"examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and **compensation scheme*s*** for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors."

Thus, the right to receive such commission-based compensation or sell proprietary products, if permitted at all under the fiduciary standard, must be conditioned on measures designed to ensure that customers receive full, clear, and timely disclosure; that they understand and consent to those arrangements; and that, at all times, notwithstanding such consent, the customers' best interests come first.

Disclosure standards are of particular importance. Every investor must receive meaningful disclosure of all information that would be relevant in evaluating the trustworthiness of the broker's advice. For example, a bland statement that a broker earns commissions conveys limited information about the broker's economic incentives. A plain language disclosure of how that compensation is determined, and how that compensation differs as a consequence of what the investor buys, is clearly in order. The investor should know, for example, if a broker receives higher commissions from proprietary mutual funds than other mutual funds, or if the broker receives extra income if the investor can be induced to buy a particular investment product.

5. The exception for a continuing duty of care must be limited. Section 913 states that nothing in the section shall require a broker to have a "continuing duty of care or loyalty" to the customer after providing advice. This provision represents a potentially massive loophole in the fiduciary standard. Claims for breach of fiduciary duty often arise when clients find themselves neglected by a broker who has engendered a reasonable expectation that the client's interests were under a continuing duty of care. The SEC must write its rule to ensure, for example, that brokers cannot resort to clauses in fine-print contracts that operate as a convenient "on-off switch" for the fiduciary duty. Instead, and at a minimum, a holistic facts and circumstances test must be developed to ensure that the duty, once triggered, only ends in accordance with the client's well-informed understanding.

6. The SEC should not be unduly influenced by pleas to protect and preserve the broker business model or the products and services that brokers offer. Such arguments are deeply flawed. They assume that the current broker business model, along with the traditional products and services offered by brokers, are of real value to investors and are worthy of preservation at all costs. But if imposing the fiduciary duty on brokers, and requiring them to act in the best interest of investors, prevents them from offering their products and services, then at a fundamental level, those products and

services are presumptively unworthy of preservation. In other words, the fiduciary duty must be applied to any brokers providing investment advice to a client, and the brokers must adapt their models, products, and services to this new and higher standard of conduct.

7. The SEC should construe "personalized investment advice" broadly. Section 913 frames the SEC's authority to impose a fiduciary duty on brokers in terms of "personalized investment advice." The "personalized" qualification represents another potentially enormous loophole. To limit the risk of evasion under the new standard, the SEC must broadly interpret the term "personalized." In any guidance to be developed, the SEC should draw on one of the most basic and important maxims of securities law and make clear that advice will be deemed personalized if it is personalized in substance and reality, regardless of form. Further, the SEC should not create "safe harbors" for ostensibly "generalized" advice, since virtually any form of advice, no matter how generalized on its face, can be deployed in a way to influence a client or prospective client and steer them toward specific investments.

To ensure that the fiduciary standard applicable to brokers as well as IAs satisfies the letter and spirit of the Dodd-Frank Act and adequately protects all customers receiving securities advice, the SEC must broadly interpret the fiduciary standard and narrowly interpret the potential carve-outs, as described above.

IV. The Request illustrates the debilitating impact that cost-benefit analysis is having on the SEC's ability to promulgate rules necessary to protect investors.

To the extent the Request was motivated by a desire to anticipate and defend against potential lawsuits challenging any fiduciary duty rule it may issue, the Request forcefully illustrates the harms arising from the agency's apparent commitment to engage in exhaustive cost-benefit analysis.

First, and most obviously, the SEC's decision to issue the Request and prolong the process due to anxiety about a future rule challenge is causing harmful delay in achieving a clearly necessary and important objective: subjecting brokers to the same protective standard of loyalty and care that IAs must meet when advising clients.

Second, the Request highlights the insurmountable challenge of attempting to catalogue and quantify all of the costs and benefits that might arise from the imposition of a fiduciary duty on brokers. For example, any truly accurate assessment of the benefits would have to include the innumerable cases of investor exploitation and abuse that will be **prevented** once the duty is in place. It would also have to attempt to measure the impact resulting from investors' increased confidence in their advisers, and any correlated increase in their willingness and ability to invest in the capital markets.

But these benefits, although profoundly important, are impossible to accurately measure.

Even attempting to estimate the future benefits of applying the fiduciary duty based on patterns of **past abuse** is immensely difficult. Clients of brokers who have been exploited in ways that the fiduciary duty could address are often completely unaware that they have been victimized. Even when investors know they have suffered damage at the hands of a broker that has subordinated the clients' interests to its own, they frequently lack the resolve or wherewithal to pursue a claim in the time-consuming and often fruitless process of industry-dominated arbitration. And, finally, because arbitration is cloaked in secrecy, rarely resulting in written decisions, even cases that are brought and decided reveal very little information.

As to possible costs of applying a fiduciary standard on brokers, those are relatively trivial, comprised primarily of training and compliance expenditures—essentially the costs of learning how not to exploit clients. Other costs, such as increased liability exposure, are not legitimate components of a cost analysis. They would only arise from a failure of a broker to comply with the fiduciary duty. No valid objection to a law or regulation can be premised on the bootstrapping notion that the regulated entity might incur the costs of defending itself when it violates the rule. Moreover, IAs have been able to bear the same costs in their own dealings, and to the extent brokers argue that their costs will be passed down to their customers, competitive market forces will help prevent or limit this threat.

These observations illustrate just some of the reasons why Congress never in fact required the SEC to conduct cost-benefit analysis in any of its rulemakings. Its actual duty is far more narrow. Whenever the SEC is engaged in rulemaking, it is vitally important to bear in mind several core principles, described in the following section, that accurately define the true nature and scope of the obligation that the SEC has when considering the economic impact of its rules. These core principles are especially important to remember as the SEC embarks on writing a fiduciary duty rule that is aimed at fulfilling the SEC's most important and fundamental mission: protecting investors.

V. As it formulates its fiduciary duty rule, the SEC should adhere to a number of core principles governing the economic analysis actually required under the securities laws.

Even when the SEC has clearly fulfilled its limited statutory duty to consider the economic impact of its rules, representatives from industry have challenged proposed rules claiming—without merit—that the SEC failed to appropriately conduct what the industry calls "cost-benefit analysis."

These attacks rest on a series of fundamentally flawed claims. For example, in challenging rules promulgated by the SEC, the industry has:

(1) greatly exaggerated the actual duty imposed on the SEC by its governing statutes, Sections 3(f) and 23(a)(2) of the Exchange Act, in effect seeking to transform that limited duty into what they call "cost-benefit analysis, but which is in really an "industry cost-only analysis;"

(2) entirely disregarded the paramount statutorily required role of the public interest in the rulemaking process; and

(3) indefensibly ignored the enormous cost of the financial crisis and the larger collective benefit of all rules designed to help prevent a recurrence of that crisis or something far worse.[5]

Accordingly, it is important that the SEC adhere to a series of core principles governing the actual contours of its duty to consider the economic impact of its rule.

1. *Under the securities laws, the SEC has no statutory duty to conduct cost-benefit analysis; in fact, its far more narrow obligation is simply to consider certain enumerated factors.*

Sections 3(f) and 23(a)(2) of the Exchange Act set forth the SEC's statutory requirement to "consider" a rule's impact on several specifically listed economic factors.[6] Specifically, Section 3(f) requires the SEC, after considering "the public interest" and the "protection of investors," "to consider . . . whether the action will promote efficiency, competition, and capital formation." Section 23(a)(2) requires the SEC to "consider among other matters the impact any such rule or regulation would have on competition," and to refrain from adopting the rule if it "would impose a burden on competition not necessary or appropriate in furtherance of the purposes of [the statute]."[7] The Exchange Act contains no language requiring a cost-benefit analysis and there is no basis for imposing any such requirement.

---

[5] *See* Better Markets, The Cost of The Wall Street-Caused Financial Collapse And Ongoing Economic Crisis is More Than $12.8 Trillion (Sept. 15, 2012), *available at* http://bettermarkets.com/sites/default/files/Cost%20Of%20The%20Crisis.pdf; *see also* U.S. Government Accountability Office, Financial Regulatory Reform: Financial Crisis Losses and Potential Impacts of the Dodd-Frank Act, GAO-13-180, at 17 (Jan. 2013), *available at* http://gao.gov/assets/660/651322.pdf.

[6] 15 U.S.C. §§ 78c(f), 78w(a)(2).

[7] Better Markets has set forth a comprehensive analysis regarding the scope of the SEC's duties under the securities laws in Better Markets, Setting The Record Straight On Cost-Benefit Analysis And Financial Reform At The SEC, at 39-44 (July 30, 2012), *available at* http://bettermarkets.com/sites/default/files/CBA%20Report.pdf. In addition, Better Markets has recently filed an *amicus curiae* brief in support of the SEC on the agency's statutory duties in *American Petroleum Inst. v. SEC*, No. 12-1398 (D.C. Cir. Oct. 10, 2012). Both the report and *amicus* brief are incorporated by reference as if fully set forth herein.

When Congress intends cost-benefit analysis to apply, it explicitly refers to "costs" and "benefits" and specifies the nature of the analysis.[8] And, when Congress wants agencies to be free from those constraints, it imposes a less burdensome requirement, thus giving overriding importance to particular statutory objectives.[9] Indeed, the Court of Appeals for the District of Columbia has recently assessed the CFTC's economic analysis duty under Section 15(a) of the Commodity Exchange Act, which actually refers to "costs" and "benefits," and confirmed that "[w]here Congress has required 'rigorous, quantitative economic analysis,' it has made that requirement clear in the agency's statute, but it imposed no such requirement here." *Inv. Co. Inst. v. CFTC*, No. 1:12-cv-00612, at 15 (D.C. Cir. June 25, 2013) (citing *American Financial Services Ass'n v. FTC*, 767 F.2d 957, 986 (D.C. Cir. 1985)); *cf., e.g.*, 2 U.S.C. § 1532(a).

The SEC's statutory duty stands in sharp contrast to the statutory provisions in which Congress explicitly mandates a netting or specific balancing of costs and benefits, let alone mentions "costs" and "benefits."

Moreover, Congress's careful choice of words in Sections 3(f) and 23(a)(2) and the case law construing similar provisions, make clear that the SEC has broad discretion in discharging its duty. The Supreme Court has long recognized that when statutorily mandated **considerations** are not "mechanical or self-defining standards," they "imply wide areas of judgment and therefore of discretion" as an agency fulfills its statutory duty.[10]

The plain fact is that the SEC has no statutory or other obligation[11] to quantify costs or benefits,[12] weigh them against each other,[13] or find that a rule will confer a net

---

8 *See American Textile Mfrs. Inst., Inc. v. Donovan*, 452 U.S. 490, 510-512 & n. 30 (1981) (stating that "Congress uses specific language when intending that an agency engage in cost-benefit analysis" and citing numerous statutory examples).

9 *See Whitman v. American Trucking Ass'ns., Inc.*, 531 U.S. 457, 471 (2001) (holding that a statute "unambiguously bars cost considerations"); *see also Nat'l Ass'n of Home Builders v. EPA*, 682 F.3d 1032, 1039 (D.C. Cir. 2012) (statutes in which agencies must "consider" the "economic" impact or "costs" do not require cost-benefit analysis); *Cent. Ariz. Water Conservation Dist. v. EPA,* 990 F.2d 1531, 1542 n.10 (9th Cir. 1993) (language in 42 U.S.C. § 7491(g)(1) requiring "consideration" does not require a cost-benefit analysis).

10 *Sec'y of Agric. v. Cent. Roig Ref. Co.,* 338 U.S. 604, 611 (1950).

11 Indeed, there is no other law which would subject the SEC to a cost-benefit duty. The APA does not require such an analysis, *Vill. of Barrington v. Surface Transp. Bd.*, 636 F.3d 650, 670-671 (D.C. Cir. 2011), and the Executive Orders on cost-benefit analysis exclude the SEC and other independent agencies. Executive Order 13,579, 76 Fed. Reg. 41,587 (July 14, 2011); Executive Order No. 13,563, 76 Fed. Reg. 3,821, § 7 (Jan. 21, 2011); Executive Order 12,866, 58 Fed. Reg. 51,735, § 3(b) (Oct. 4, 1993).

12 *Cf.* 42 U.S.C. § 300g-1(b)(3) (imposing a duty on the Environmental Protection Agency to use analysis of specific factors including the "[q]uantifiable and nonquantifiable health risk reduction benefits," the "[q]uantifiable and nonquantifiable costs," and "[t]he incremental costs and benefits associated with each alternative."). Courts have repeatedly held that an agency need not quantify the costs and benefits of a rule when a statute does not require it. *See, e.g., FMC Corp. v. Train*, 539 F.2d 973, 978-979 (4th Cir. 1976) (finding that 33 U.S.C. §§ 1314(b)(1)(B), (b)(2)(B) and § 1316 do not require quantification of the benefits in monetary terms). In fact, the D.C. Circuit has explicitly recognized that even in a cost-benefit analysis an agency's "predictions or conclusions" do not necessarily need to be "based on a rigorous, quantitative economic analysis." *Am. Fin. Services Ass'n. v. FTC*, 767 F.2d 957, 986 (D.C. Cir. 1985); *see also Pennsylvania Funeral Directors Ass'n v. FTC*, 41 F.3d 81, 91 (3d Cir. 1994)

benefit before promulgating it. The rationale for this flexible obligation in the law is clear: requiring the SEC to conduct a resource intensive, time consuming, and inevitably imprecise cost-benefit analysis as a precondition to rulemaking would significantly impair the agency's ability to implement Congress's regulatory objectives. The industry's desire to have its costs prioritized over all other costs (what they falsely refer to as "cost-benefit analysis") does not change the law, the reasoned basis for the law, or the underlying policy.

2. The SEC must be guided by the public interest and the protection of investors as it considers the economic impact of its rules, not by concerns over the costs of regulation imposed on industry.

The SEC's preeminent duty when promulgating rules is to protect investors and the public interest. The agency was established for the purpose of implementing the securities laws, and therefore its primary duty is to achieve the legislative objectives of those laws, which are first and foremost to protect investors and the public interest from fraud, abuse, and manipulation in the securities markets. As is evident from the securities laws themselves, their legislative history, and the specific delegations of rulemaking authority, the public interest and protection of investors is a key consideration in the SEC's rulemaking process. Indeed, Section 3(f) of the Exchange Act explicitly refers to "the protection of investors" and "the public interest," but does not mention any industry-focused concerns, such as compliance costs or the feasibility of conforming to rule requirements.[14]

Moreover, the SEC's duty to protect investors and the public interest has renewed importance in light of the 2008 financial crisis. The financial crisis is a powerful reminder of the need to remain focused on the core purposes of securities regulation and the SEC's overriding duty to protect the public, investors, and the integrity of the markets. The Supreme Court's admonition about the importance of raising standards of conduct to the highest possible level following the Great Depression applies with equal force today:

> "'It requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is

(recognizing that "much of a cost-benefit analysis requires predictions and speculation, in any context," and holding that the "absence of quantitative data is not fatal").

13 Even when a statute refers to "costs" and "benefits," Courts refuse to impose a duty to conduct cost-benefit analysis absent language of comparison in the statute. *See Weyerhaeuser Co. v. Costle,* 590 F.2d 1011, 1045 (D.C. Cir. 1978); *see also Am. Petroleum Inst. v. EPA*, 858 F.2d 261, 265 & n.5 (5th Cir. 1988); *Reynolds Metal Co. v. EPA*, 760 F.2d 549, 565 (4th Cir. 1985).

14 *Cf.* 42 U.S.C. § 300g-1(b)(3)(C) (requiring analysis of certain costs of safe drinking water regulations including costs that "are likely to occur solely as a result of compliance with the maximum contaminant level, including monitoring, treatment, and other costs"); 42 U.S.C. § 6295(d) (1976 ed., Supp. II) (requiring a weighing of the economic impact on manufacturers and the savings in operating costs as "compared to any increase in the price of, or in the initial charges for, or maintenance expenses of, the covered products which are likely to result").

> that the highest ethical standards prevail' in every facet of the securities industry."[15]

If these goals are subordinated to industry concerns over the costs of regulation in the rulemaking process, then the reforms embodied in the Dodd-Frank Act will have little chance of protecting our markets and our economy from the ravages of another financial crisis. Thus, in promulgating rules under the Dodd-Frank Act, the SEC must be guided by the preeminent concerns of the public interest and the protection of investors, not the burdens of regulation on industry.

3. For any rule promulgated in accordance with and in furtherance of the Dodd-Frank Act, the ultimate public interest and investor protection consideration is implementing the reforms that Congress passed to provide for a safer and sounder financial system and to prevent another financial crisis.

The statutory authority for a fiduciary duty rule is the Dodd-Frank Act. The SEC must therefore consider and give proper weight to the overriding goal that Congress intended to achieve when it passed the comprehensive, interrelated law, and in terms of the enormous benefit that the rules collectively will provide to the public. That goal is to prevent another financial collapse and economic crisis, and that benefit is to avoid the economic costs, hardships, and human suffering that would inevitably accompany such disastrous events.

The dollar cost alone of the financial collapse and still-unfolding economic crisis is conservatively estimated to be in the trillions. A study by Better Markets estimates that those costs will exceed $12.8 trillion.[16] In addition, the Government Accountability Office has recently issued the results of a study on the costs of the crisis, observing that "the present value of cumulative output losses [from the crisis] **could exceed $13 trillion**."[17] Therefore, as the SEC considers the public interest and the protection of investors under Sections 3(f) and 23(a)(2), it must continue to consider, above all, the benefits of the entire collection of reforms embodied in the Dodd-Frank Act, of which any specific rule is but a single, integral part.

Congress passed the Dodd-Frank Act knowing full well that it would impose significant costs on industry, yet it determined those costs were not only justified but necessary to stabilize our financial system and avoid another financial crisis. Those costs include the elimination of extremely profitable lines of business as well as significant and ongoing compliance costs. A leading example is the establishment of the

---

15 *SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 186-87 (1963) (quoted authorities omitted).

16 *See* BETTER MARKETS, THE COST OF THE WALL STREET-CAUSED FINANCIAL COLLAPSE AND ONGOING ECONOMIC CRISIS IS MORE THAN $12.8 TRILLION (Sept. 15, 2012), *available at* http://bettermarkets.com/sites/default/files/Cost%20Of%20The%20Crisis_0.pdf, incorporated here as if fully set forth herein.

17 U.S. GOVERNMENT ACCOUNTABILITY OFFICE, FINANCIAL REGULATORY REFORM: FINANCIAL CRISIS LOSSES AND POTENTIAL IMPACTS OF THE DODD-FRANK ACT, GAO-13-180, at 17 (Jan. 2013) (released Feb. 14, 2013), *available at* http://gao.gov/assets/660/651322.pdf (emphasis added).

1825 K Street, NW, Suite 1080, Washington, DC 20006 TELEPHONE (1) 202.618-6464 FAX (1) 202.618.6465 WEBSITE bettermarkets.com

new, comprehensive regulatory regime for swaps. It will require the financial industry to incur significant costs arising from new personnel and technology, ongoing compliance, margin and collateral, and reduced revenues and profits.

However, the financial reform law and the rules implementing it do not, in fact, add any incremental costs (or, if they do, those costs are *de minimis*). Rather, they reallocate costs so that industry bears them in a regulated environment that **prevents** financial failure and bailouts. As a result, the public and society are spared the massive costs of responding to economic crises after the fact.[18]

Congress fully understood this. It knew that re-regulation would impose costs on the industry, in some cases totaling billions of dollars. The Dodd-Frank Act reflects Congress's unflinching determination to shift the costs of de-regulation and non-regulation of the financial industry back to the industry from a society that has paid and continues to pay the bill for industry's unregulated excesses. In substance, Congress conducted its own cost-benefit analysis and concluded that the enormous collective benefits of the law far exceeded the costs and lost profits that industry would have to absorb.[19]

Against the backdrop of the worst financial and economic crises since the Great Depression, it is inconceivable that Congress would enact sweeping reforms and then allow the implementation of those reforms to hinge on the outcome of a biased, one-sided cost-benefit analysis that ignored the overriding purpose of the new regulatory framework—and that gave controlling weight to cost concerns from the very industry that precipitated the crisis and inflicted trillions of dollars in financial damage and human suffering across the country.

Indeed, had Congress wanted the financial regulatory agencies to conduct cost-benefit analysis prior to promulgating the rules under the Dodd-Frank Act, it would have clearly said so. Congress passed the Dodd-Frank Act fully aware of the specific economic analysis provisions in the federal agencies' governing statutes—like Sections 3(f) and 23(a)(2) of the Exchange Act—and fully aware of how to impose a cost-benefit analysis requirement. Yet, it made no changes to those provisions, thereby affirming congressional intent that those specific provisions should control as they were originally written and intended.

VI. A rule applying the fiduciary duty to brokers under Section 913 of the Dodd-Frank Act will satisfy the limited economic analysis test that applies.

Even a cursory analysis should give the SEC confidence that a rule applying the fiduciary duty to brokers who dispense investment advice will satisfy the applicable economic analysis test under the securities law, properly interpreted in accordance with the guidelines above.

---

18 *See* BETTER MARKETS, SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC, at 39-44 (July 30, 2012), *available at* http://bettermarkets.com/sites/default/files/CBA%20Report.pdf.

19 *Id.* at 43.

First and foremost, such a rule will protect investors from conflicts of interest and other forms of abuse at the hands of brokers subject to weaker standards than IAs. This will help fulfill the SEC's preeminent duty to protect investors and the public interest.

Second, the rule will promote efficiency by ensuring that more of each investor's funds can be devoted to sound investments, rather than wasted on unnecessary fees, charges, and securities products that increase a broker's profits at the expense of their clients.

Third, the rule will promote fair competition by correcting a gross disparity in the regulatory treatment of brokers and IAs when they are performing the same function.

Fourth, the rule will promote increased capital formation by raising investor confidence in the securities markets and the firms that provide advice.

Finally, by raising the standard of care applicable to brokers who advise clients—including at a minimum the institutional clients discussed above—about investing in securities, the rule will also help further the overarching goals of the Dodd-Frank Act: limiting systemic risk and promoting accountability in the financial system.

CONCLUSION

We hope these comments are helpful as the SEC develops its rule implementing the fiduciary duty in accordance with Section 913 of the Dodd-Frank Act.

Sincerely,

Dennis M. Kelleher
President & CEO

Stephen W. Hall
Securities Specialist

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

dkelleher@bettermarkets.com
shall@bettermarkets.com

www.bettermarkets.com