September 17, 2014

Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Temporary Rule Regarding Principal Trades With Certain Advisory Clients; File No. S7-23-07

Dear Secretary:

Better Markets, Inc.[1] appreciates the opportunity to comment on the above-captioned temporary rule regarding principal trades with certain advisory clients (the "Proposed Rule") of the Securities and Exchange Commission ("SEC").[2] The Proposed Rule would delay the sunset date for "temporary" rule 206(3)-3T ("Temporary Rule") from December 31, 2014, to December 31, 2016. Temporary Rule 206(3)-3T allows investment advisers that are also registered as broker-dealers to engage in principal trading with clients without complying with the full set of disclosure and consent requirements normally applicable under the Investment Advisers Act of 1940 ("Advisers Act" or "Act").

Better Markets opposes the extension of the Temporary Rule for a number of reasons: (1) it impermissibly rewrites the Advisers Act; (2) it will perpetuate a situation in which investors are exposed to a heightened risk of abuse in principal trades, essentially for the convenience and benefit of broker-dealer investment advisers; (3) it reflects an unacceptable de-regulatory presumption, by weakening investor protections **while** the SEC's lengthy study of the rule is ongoing and incomplete; and (4) it serves as yet another reminder that the SEC has inexcusably failed to impose the fiduciary duty on broker-dealers giving investment advice, thus unnecessarily subjecting millions of everyday investors to conflicted advice that does not serve their best interests.

---

[1] Better Markets, Inc. is a 501(c)3 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.

[2] Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 79 Fed. Reg. 48709 (Aug. 18, 2014).

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

## INTRODUCTION

The basis for the Proposed Rule is the Advisers Act, which imposes a fiduciary standard of conduct on one "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."[3] That standard means the adviser must "act in the best interest of the customer without regard to [his own] financial or other interest."[4]

In passing the Act, Congress recognized that when advisers seek to trade as a principal with a client, a significant conflict of interest arises and the client faces a special threat of abuse. Therefore, among other restrictions, the Act prohibits a fiduciary from engaging in such principal trades unless certain requirements are met. Specifically, the Act provides that investment advisers may not, while "acting as principal for his own account, knowingly to sell any security to or purchase any security from a client . . . without disclosing to such client in **writing** before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction."[5]

In 2005, the SEC adopted Rule 202(a)(11)–1, which excluded broker-dealers with fee-only client accounts from being considered investment advisers under the Advisers Act, and therefore exempted these broker-dealers from the Act's requirements, including the principal trade restrictions and conditions.[6] In 2007, the D.C. Circuit Court of Appeals vacated this rule in *Financial Planning Association v. SEC* ("*FPA*").[7] The court determined that the Act's definition of investment adviser, and its enumerated exceptions, "is unambiguous, and that, therefore, the SEC has exceeded its authority in promulgating the final rule."[8] As a result of the *FPA* decision, broker-dealers who offer fee-only accounts are subject to the Act, including its provisions regulating principal trades and imposing the fiduciary duty.

In the aftermath of that decision, dual-registrants informed the SEC that "unless they are provided an exemption from, or an alternative means of complying with, section 206(3) of the Advisers Act, they would be unable to" participate in the same principal trading with fee-based brokerage clients in which they previously engaged.[9] The original Temporary Rule release explains that these firms "generally do not offer principal trading to current advisory clients" because they would be subject to section 206(3).[10]

---

3 Investment Advisers Act of 1940, § 202(a)(11), 15 U.S.C. § 80b-2(a)(11).

4 Investment Advisers Act of 1940, § 211(g)(1), 15 U.S.C. § 80b-2(g)(1).

5 Investment Advisers Act of 1940, § 206(3), 15 U.S.C. § 80b-6(3) (emphasis added).

6 Securities and Exchange Commission, Certain Broker-Dealers Deemed Not To Be Investment Advisers, 70 Fed. Reg. 20424 (Apr. 19, 2005).

7 *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007).

8 *FPA*, 482 F.3d at 493.

9 Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 72 Fed. Reg. 55022, 23 (Sept. 28, 2007).

10 "Firms that are registered both as broker-dealers and investment advisers generally do not offer principal trading to current advisory clients (or do so on a very limited basis), and the rule vacated in the *FPA* decision had allowed broker-dealers to offer fee-based accounts without complying with the Advisers Act, including the requirements of section 206(3). Most informed us that they plan to discontinue fee-based brokerage accounts as a result of the *FPA* decision because of the application of the Advisers Act." *Id.* at 55023.

The Temporary Rule, finalized shortly after the *FPA* decision, allows investment advisers also registered as broker-dealers to trade with clients from their own accounts without providing written pre-trade notification to their clients. In explaining its rationale for implementing the Temporary Rule, rather than allowing the statutory language to govern, the SEC wrote that it was adopting the Temporary Rule because firms have refused to comply with section 206(3) as written:

> We believe this rule both protects investors' choice—fee-based brokerage customers would be able to choose an account that offers a similar set of services (including access to the same securities) that were available to them in fee-based brokerage accounts—and avoids disruption to, and confusion among, investors who may wish to access and sell securities only available through a firm acting in a principal capacity and who, as a result, may no longer be offered any fee-based account.[11]

The SEC also wrote, "making the rule temporary allows us an opportunity to observe how those firms use the alternative means of compliance provided by the rule, and whether those firms serve their clients' best interests."[12]

The Temporary Rule, originally set to expire in 2009, has already been subject to three extensions, and the Proposed Rule would be the fourth. The SEC's more recent justification for extending it on a temporary basis—for 2 more years on top of 7 years[13]—is that it seeks to address principal trading in connection with the broader consideration of "the legal or regulatory standards of care for broker-dealers, investment advisers, and persons associated with these intermediaries," pursuant to Section 913 of the Dodd-Frank Act.[14]

## SUMMARY OF COMMENTS

Extending the Temporary Rule is wrong for multiple reasons. The rule strips away a statutory protection against the abuses that can occur when broker/advisers want to sell securities to their clients as a principal. Congress clearly intended those protections to apply, since they were mandated in the Advisers Act itself, and **the SEC does not have the authority to rewrite the law**.

The Temporary Rule raises a broader and more fundamental concern regarding the SEC's regulatory approach. Even if the SEC had the authority to change the statutory protections governing principal trading, and assuming that the SEC is uncertain about whether or not such a rule is appropriate and necessary, it should maintain existing investor protections pending any further analysis. Here, the SEC has followed just the opposite course by attempting to repeal a

---

[11] Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 72 Fed. Reg. 55022, 25 (Sept. 28, 2007).

[12] Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 72 Fed. Reg. 55022, 25 (Sept. 28, 2007).

[13] One has to wonder if the Commission would agree with a registrant using the word "temporary" in a similar fashion, i.e. "temporarily" not complying with the law for years.

[14] Securities and Exchange Commission, Principal Trades with Certain Advisory Clients, 75 Fed. Reg. 82236 (Dec. 30, 2010).

statutory safeguard in the Advisers Act and exposing investors to a heightened threat of abuse while it spends years considering exactly what measures should be adopted on a permanent basis. This anti-investor presumption in the regulatory process is unacceptable.

Finally, the Proposed Rule is yet another clear reminder that the SEC must adopt the fiduciary standard of conduct for broker-dealers that give investment advice about securities. The SEC justifies the extension of the Temporary Rule with the argument that a final regulatory approach to principal trading should await the SEC's resolution of the larger question regarding how best to regulate brokers who give investment advice. But for years, the SEC has failed to resolve that issue, dragging its feet with studies and endlessly compiling information that it does not need. The SEC cannot justify delay on the Temporary Rule, which contradicts a statutory mandate, by relying on its own prolonged failure to address another critically important issue. In fact, there is no legitimate reason for the SEC to defer action any longer: Investors need the fiduciary duty as a protection against the conflicted advice they receive from broker-dealers.

## OVERVIEW OF THE TEMPORARY RULE

Section 206(3) of the Adviser's Act provides that investment advisers may not, while "acting as principal for his own account, knowingly to sell any security to or purchase any security from a client . . . without disclosing to such client in **writing** before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction."[15]

The Temporary Rule provides that an adviser "shall be deemed in compliance" with this requirement as long as the adviser complies with a number of conditions, but it allows the adviser to make oral disclosure and receive oral consent prior to the trade. The Proposed Rule would extend these provisions in the Temporary Rule until 2016, without making any substantive changes.

## COMMENTS ON THE CONTINUATION OF THE TEMPORARY RULE

### 1. The SEC lacks authority to extend the Temporary Rule.

As a threshold matter, it is clear and indisputable from the text of the statute and the Temporary Rule that there is an irreconcilable conflict between the two. The Temporary Rule seeks to de facto amend the Adviser's Act by deleting the requirement that an adviser seeking to engage in a principal trade with a client first provide advance written disclosure to the client on a transaction-by-transaction basis. The SEC does not have and has never had the legal authority to adopt the Temporary Rule or to repeatedly extend it. Neither of the statutory provisions that the SEC has relied upon give it the authority to rewrite the Adviser's Act in such a manner.

The SEC invokes Section 211(a).[16] But that provision is merely a general grant of authority to write rules fleshing out the statutory terms in the Adviser's Act (through definitions, for example), and to enable the SEC to exercise the "functions and powers conferred upon the Commission" throughout the Act. As the D.C. Circuit has held, Section 211(a) "suggests no

---

15 Investment Advisers Act of 1940, § 206(3), 15 U.S.C. § 80b-6(3) (emphasis added).
16 Investment Advisers Act of 1940, § 211(a), 15 U.S.C. § 80b-11(a).

intention by Congress that the SEC could ignore" other explicit requirements in the statute.[17] In short, that rulemaking authority is limited "to adopting regulations to carry into effect the will of Congress as expressed in the statute," not to nullify that will as the SEC has done in the Temporary Rule.[18]

The SEC also invokes Section 206A.[19] That provision grants the SEC authority to create exemptions from provisions of the Adviser's Act. However, the plain language of Section 206A makes clear that the authority is limited and can only be exercised "**if and to the extent** that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the [Adviser's Act]."[20] The Temporary Rule does not meet these conditions, since it **removes** an investor protection—advance written disclosure of a conflict of interest arising from a principal trade—and undermines the basic policy objectives of the Adviser's Act. In addition, as the D.C. Circuit has also observed, the SEC generally uses that type of authority to exempt persons "not within the intent of the [statute]" and "to take account special situations not foreseen" when the statute was drafted.[21] But investment advisers that are also registered as broker-dealers do not fall into either of those categories, and they do not trigger the rationale for exercise of the exemptive authority found in Section 206A.

It follows under *Chevron* that the Temporary Rule is invalid. Under *Chevron*, an agency regulation is invalid if "Congress has directly spoken to the precise question at issue" and the regulation conflicts with Congress's mandate.

> If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.[22]

Here, the Act provides that an adviser may not, while "acting as principal for his own account, knowingly to sell any security to or purchase any security from a client . . . without disclosing to such client **in writing** before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction."[23] In this section, Congress "has directly spoken to the precise question at issue," and has determined that, to trade as a principal, an adviser must (1) provide a written statement to the client, (2) before the completion of each trade, (3) that the adviser is acting as a principal for his own account, (4) and receive the client's consent to act in a principal capacity for that trade.

The Temporary Rule, contrary to the Advisers Act, allows dual-registrants to provide oral disclosure prior to conducting the trade and send written confirmation only after the fact. It is

---

17 *FPA*, 482 F.3d at 490.

18 *FPA*, 482 F.3d at 493, *paraphrasing Bd. of Governors v. Dimension Fin. Corp.*, 474 U.S. 361, 374 (1986).

19 Investment Advisers Act of 1940, § 206A, 15 U.S.C. § 6a.

20 Investment Advisers Act of 1940, § 206A, 15 U.S.C. § 6a (emphasis added).

21 *FPA,* 482 F.3d at 491 *quoting National Asso. of Sec. Dealers, Inc. v. Securities & Exchange Com.*, 420 F.2d 83, 92 (D.C. Cir. 1969).

22 *Chevron, U.S.A. v. National Resources Defense Council*, 467 U.S. 837, 842 (1984).

23 Investment Advisers Act of 1940, § 206(3), 15 U.S.C. § 80b-6(3) (emphasis added).

therefore inconsistent with the Act, and must give way to "the unambiguously expressed intent of Congress."[24]

2. Extending the Temporary Rule would expose investors to a continued and heightened risk of abuse for no legitimate reason.

A. Principal trades pose a threat to investors.

There is no question that principal trades create conflicts of interest and opportunities for advisers to take advantage of their clients. The classic example is "dumping:" Advisers may use principal trades to "'dump' unmarketable securities or securities that the adviser believes may decline in value into an advisory account" held by an unwitting client.[25] The Release indicates that the SEC staff has not found recent evidence of dumping, but it nevertheless recognizes that this form of abuse was one the very harms that Section 206(3) of the Adviser's Act was designed to redress.

The case law illustrates other forms of abuse that can arise from principal trades. For example, an adviser may buy and sell with a client for the purpose of immediately covering those transactions in the market at favorable prices, thus taking for itself gains that could have benefited the client.[26] The Release reveals yet other problems associated with principal trading under the Temporary Rule, including the failure of some firms to maintain policies and procedures required to ensure that firms are complying with the terms of the Temporary Rule.[27] It is also likely that investors are often unaware of instances where principal trades with their broker have caused harm, and these abuses go undetected.

B. Written disclosure can help address those abuses.

It is equally clear that written disclosure in advance of a principal trade can help mitigate the threat of abuse. As the Release itself acknowledges, "if the [Temporary Rule] is allowed to expire, and firms engage in principal transactions with advisory account clients pursuant to the requirements of section 206(3) of the Act, investors will be able to more fully evaluate the conflicts of the principal transactions prior to the trades."[28]

The Act requires advisers "to disclose facts necessary to alert the client to the adviser's potential conflicts of interest in a principal or agency transaction."[29] Specifically, the SEC has found that if "an adviser also provides a client with information that is sufficient to inform the client of the conflicts of interest faced by the adviser in engaging in the transaction, then the

---

[24] *Chevron,* 467 U.S. at 843.

[25] Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 79 Fed. Reg. 48709, 13 (Aug. 18, 2014).

[26] *See Geman v. Securities & Exchange Com.*, 334 F.3d 1183 (10th Cir. 2003).

[27] Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 79 Fed. Reg. 48709, 11, n. 19 & 20 (Aug. 18, 2014).

[28] Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 79 Fed. Reg. 48709, 13 (Aug. 18, 2014).

[29] Securities and Exchange Commission, Interpretation of Section 206(3) of the Investment Advisers Act of 1940, Release No. IA-1732 (July 17, 1998), *noting* "Section 206(3) should be read together with Sections 206(1) and (2)."

adviser will have provided the information necessary for the client to make an informed decision for purposes of Section 206(3)."[30] This written disclosure statement "enables the client to evaluate, at his own leisure, the risks and the advantages" of a principal transaction,[31] and specifically helps avoid a situation where an adviser has "structured the procedures for obtaining consent in such a manner that the client has no choice but to consent."[32]

As far back as 1945, the SEC articulated which disclosures were necessary for an adviser to provide to a client under Section 206(3). In a release that year, the SEC provided that:

> The disclosure should include, as a minimum, (a) the capacity in which the investment adviser proposes to act, (b) the cost to the adviser of any security which he proposes to sell to his client . . . , and (c) the best price at which the transaction could be effected by or for the client elsewhere if such price is more advantageous to the client than the actual purchase or sale price. Moreover, any disclosure of the cost to the investment adviser (or the price he expects to receive on resale) should be so phrased that its full import is obvious to the client. The disclosure should include a statement of the total amount of the cost or resale price (or the total profit) in dollars and cents…[33]

This is significant information, which a client is unlikely to fully appreciate if it is delivered simply through an oral recitation, and which is subject not only to de-emphasis, information overload, and gamesmanship, but also to ambiguity, complexity, and self-interest.

Under the Temporary Rule, a dual-registrant may have the client sign "written, revocable consent prospectively authorizing" self-dealing by the adviser at the beginning of an adviser/client relationship. But the document may be signed along with an overwhelming collection of other forms the investor does not read, likely making that disclosure of little if any real value.[34] The Advisers Act directly and clearly addresses and mitigates this problem by requiring written disclosure on a transaction-by-transaction basis, where the client has only one document related to one transaction to focus on.

Although the Temporary Rule requires advisers to provide clients oral notice of a specific principal trade, this can be accomplished as an aside, as a technical matter that is portrayed as having little import to the client, or as part of a mountain of information that conceals more than

---

[30] Securities and Exchange Commission, Interpretation of Section 206(3) of the Investment Advisers Act of 1940, 63 Fed. Reg. 39505, 07 (July 17, 1998).

[31] Gretchen L. Jankowski, *Comment: The Ethics Involved in Representing Multiple Parties in a Business Transaction: How to Avoid Being Caught Between Scylla and Charybdis Within the Confines of the Maryland Disciplinary Rules*, 23 U. Balt. L. Rev. 179, 211 (1993).

[32] Securities and Exchange Commission, Interpretation of Section 206(3) of the Investment Advisers Act of 1940, 63 Fed. Reg. 39505, 07 (July 17, 1998).

[33] Securities and Exchange Commission, Investment Advisers Act Release No. 40, 11 Fed. Reg. 10997 (Jan. 5, 1945).

[34] LIMRA, *LIMRA Study: Many Americans Don't Fully Read Retirement Plan Disclosures; Few Know What Fees They Pay*, (Aug. 27, 2012), *available at* http://www.limra.com/Posts/PR/News_Releases/LIMRA_Study__Many_Americans_Don_t_Fully_Read_Retirement_Plan_Disclosures;_Few_Know_What_Fees_They_Pay.aspx.

it reveals. The conversation may provide little or no meaningful information to the client about the true nature of principal trading and the harms that can flow from it.[35]

It is well known that "sellers can diminish the force of oral disclosures by the way they present them,"[36] as "oral statements are by their nature more seductive than writings."[37] A client certainly will have an easier time deciding whether or not to participate in the principal transaction if it receives the details of the proposed trade in writing, rather than having heard them once orally. The U.S. Supreme Court has noted that written statements "lack the coercive force of the personal presence of a trained advocate."[38] Thus oral statements can enable the speaker to maneuver a client into his chosen course of action. The Federal Trade Commission has noted that "oral disclosures are inherently unreliable" and are "inherently inconsistent" with statutes that require written disclosure.[39] The same is true here.

C. The decision to de-regulate pending a final determination on the Temporary Rule has no valid justification.

The SEC advances two reasons for extending the Temporary Rule pending further deliberation, neither of which is valid. First, it contends that if firms were required to comply with the transaction-by-transaction written disclosure requirements, then investment advisers also registered as broker-dealers would be burdened because they "may be required to make substantial changes to their disclosure documents, client agreements, procedures, and systems."[40] But even assuming this hypothetical concern were valid, it is irrelevant. Congress did not specify that industry burden or cost was a basis for the SEC to carve-out exceptions to the express mandates of the Adviser's Act. And, that is not the SEC's job. Its concerns are supposed to be, first and foremost, the protection of investors.

Second, the SEC claims that allowing the Temporary Rule to lapse could limit the access of some clients of advisory firms to certain securities.[41] However, this point merely begs the question: Is it desirable for the client to have access to securities offered in principal trades or not? The very point of the restrictions on principal trading is that firms may be giving their clients access to very undesirable securities or very undesirable terms. Moreover, the Release

---

[35] Oral disclosure will also turn any dispute between an adviser and client that turns on the adequacy of disclosure into a "he said/she said" argument lacking proof on either side. It has been noted that "efforts to enforce [sales transactions] invariably come down to credibility judgments about whether fact-finders believe the consumer, who claims no disclosure was provided, or the seller, who claims it was." Jeff Sovern, *Toward a Theory of Warranties in Sales of New Homes: Housing the Implied Warranty Advocates, Law and Economics Mavens, and Consumer Psychologists under One Roof*, 1993 Wis. L. Rev. 13, 103 (1993), *noting* William C. Whitford, *The Functions of Disclosure Regulation in Consumer Transactions,* 1973 Wis. L. Rev. 400, 448 (1973).

[36] Jeff Sovern, *Toward a Theory of Warranties in Sales of New Homes: Housing the Implied Warranty Advocates, Law and Economics Mavens, and Consumer Psychologists under One Roof*, 1993 Wis. L. Rev. 13, 103 (1993).

[37] Robert A. Prentice, *The Future of Corporate Disclosure: The Internet, Securities Fraud, and Rule 10b-5*, 47 Emory L.J. 1, 67 (1998).

[38] *Zauderer v. Office of Disciplinary Counsel of Supreme Court*, 471 U.S. 626, 642 (1985).

[39] *USLIFE Credit Corp.*, 91 F.T.C. 984 (1978), modified, 92 F.T.C. 353 (1978).

[40] Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 79 Fed. Reg. 48709, 11 (Aug. 18, 2014).

[41] Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 79 Fed. Reg. 48709, 11 (Aug. 18, 2014).

does not distinguish why compliance with this one mandated disclosure, relative to the many other protections mandated in the Advisers Act, would deprive clients any more or less of certain choices: Clients could still have access to the securities that are available via principal trades, provided the firm complied with the express terms of the Advisers Act.

3. To the extent the SEC really needs more time to evaluate whether the Temporary Rule provides a benefit to investors over the Section 206(3) language itself, it must do so in a manner that protects investors and without attempting to revise the Adviser's Act pending that review.

The SEC's handling of the Temporary Rule reveals a deeper flaw in the agency's regulatory approach. In 2007, the SEC initially adopted the rule on a temporary basis so that, before deciding on a permanent approach, it could collect information on "whether, when [firms] conduct principal trades with their clients, they put their clients' interests first."[42] But this reversed the SEC's most basic priorities: investor protection and the public interest. Instead, the SEC should have adhered to the Adviser Act and modified the approach to principal trading only **within Congressional boundaries** and only **if** further analysis provided compelling evidence that an "exemption is necessary or appropriate in the public interest and consistent with the protections of investors."[43]

The SEC has adopted a presumption against investor protection purportedly while it examines the matter further. This approach is legally unacceptable, as explained above, and it is also indefensible as a matter of regulatory policy at an agency whose primary mission is to protect investors.

Compounding the problem, the SEC now proposes to continue collecting information and conducting its analysis for another two years—which will round out almost a decade of delay and indecision by the SEC. The Temporary Rule was first adopted in September of 2007. Since then, it has undergone the following series of extensions:

- In December 2009, the SEC extended the sunset date to December 31, 2010, because it "needed additional time to understand how, and in what situations, the rule was being used."[44]
- In December 2010, the SEC extended the Temporary Rule for two years, "while we conduct the study mandated by Section 913 of the Dodd-Frank Act and consider more broadly the regulatory requirements applicable to broker-dealers and investment advisers."[45]

---

42 Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 72 Fed. Reg. 55022, 29 (Sept. 28, 2007).

43 Investment Advisers Act of 1940, § 206A, 15 U.S.C. § 6a.

44 Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 79 Fed. Reg. 48709, 10 (Aug. 18, 2014).

45 Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 75 Fed. Reg. 82236, 37 (Dec. 30, 2010).

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

- In July 2011, the SEC reiterated that the Temporary Rule would be reconsidered "[a]s part of our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers,"[46] which is the subject of an SEC study released in January 2011.

- In December 2012, the SEC extended the Temporary Rule once again for two years "to engage in a review of the regulatory obligations of broker-dealers and investment advisers."[47]

- In this Proposed Rule, the SEC is again proposing to delay a final determination regarding the Temporary Rule for two more years, pending "broader consideration of fiduciary obligations and other regulatory requirements applicable to broker-dealers and investment advisers."[48]

Thus, the SEC proposes delaying a final decision on a so-called Temporary Rule until *at least* nine years after it was first promulgated and enforced and one which contradicts an express statutory mandate. And this delay is self-imposed, as it rests squarely on the agency's failure to act under Section 913 of the Dodd-Frank Act.

4. The Proposed Rule highlights the urgent need to adopt a rule applying the fiduciary duty to broker-dealers who act as advisers, as Congress expressly authorized in Section 913 of the Dodd-Frank Act.

The SEC claims that it should formulate a long-term approach to principal trading only as part of its "broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers" under Section 913 of the Dodd-Frank Act.

As a threshold point, this is no justification for further extending the Temporary Rule, as Section 913 is inapplicable here. Nowhere in Section 913 does Congress give the SEC the authority to reduce the disclosures investment advisers or dual-registrants must provide to clients about principal trading.

---

[46] Staff of the U.S. Securities and Exchange Commission, *Report on Review of Reliance on Credit Ratings: As Required by Section 939A(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, (July 2011) at 23, quoting Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 75 Fed. Reg. 82236, 37 (Dec. 30, 2010). Additionally, the SEC wrote that "the staff, in preparing any recommendation to the SEC regarding whether Rule 206(3)-3T should be amended, replaced, or allowed to lapse, will address the requirements of Section 939A." However, the SEC delayed implementing these Dodd-Frank Section 939A requirements in its 2012 re-proposal and in this Proposed Rule because "the credit rating requirement in the temporary rule would be better addressed after the Commission completes its review of the regulatory standards of conduct that apply to broker-dealers and investment advisers. Therefore, we are not proposing any substantive amendments to the rule at this time." Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 79 Fed. Reg. 48709, 10, n.13 (Aug. 18, 2014).

[47] Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 77 Fed. Reg. 76854, 59 (Dec. 31, 2012).

[48] Securities and Exchange Commission, Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 79 Fed. Reg. 48709, 14 (Aug. 18, 2014).

Second, the SEC should have acted long ago to exercise the authority granted in Section 913, and to apply the fiduciary standard to broker-dealers dispensing investment advice. It should not now be heard to complain that it cannot resolve an important regulatory issue due to an impasse of its own making. Moreover, it appears that the SEC may **never** exercise its authority to raise the standard of conduct for broker-dealers who act as advisers. Thus, linking the Temporary Rule to progress under Section 913 places the matter of principal trading into potentially indefinite limbo.

The SEC must promulgate and finalize a fiduciary duty rule for broker-dealers without further delay. This step is essential to establish the basic protections against conflicted advice that all investors expect and deserve. For years, the brokerage industry has stretched the registration exemption in the 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. Yet they are not subject to the fiduciary standard and do not have to act in the best interest of their clients, unlike investment advisers subject to the Advisers Act.

Investors have waited far too long for the SEC to rectify this regulatory imbalance and nothing can justify continued inaction:

- There is no logical basis for maintaining two separate standards of conduct governing those who give investment advice about securities. Regulated entities engaged in the same conduct should be subject to the same regulatory standards.

- There is no legal justification for maintaining a lower standard of conduct for broker-dealers giving investment advice. The Adviser's Act does not create a wholesale exemption for broker-dealers. On the contrary, the exemption is narrowly tailored to exempt them only where two criteria have been met: Their advice is solely incidental to brokerage activity and they receive no special compensation for the advice. The brokerage industry has far exceeded these boundaries, and the law allows the SEC to act.

- Moreover, Congress has expressly authorized the SEC to impose the fiduciary standard of conduct on broker-dealers giving investment advice about securities. That authority was conferred **over four years ago** in Section 913 of the Dodd-Frank Act.

- For over 25 years, investor advocates have been warning that the disparate regulation of broker-dealers and investment advisers performing the same advisory function harms investors and must be corrected.[49]

- Repeated studies show that a fiduciary standard for broker-dealers is necessary and appropriate for the protection of investors. Over three-and-a-half years ago, the SEC's own staff finalized its study on the effectiveness of existing legal or regulatory standards

[49] Roper, Barbara, FINANCIAL PLANNING ABUSES: A GROWING PROBLEM, July 1987.

of care for investment advisers and broker-dealers pursuant to Section 913.[50] The primary and unequivocal recommendation in that study was 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."[51] The Study further recommended that the fiduciary standard be "no less stringent than currently applied to investment advisers under the Advisers Act."[52]

- Other studies have removed any doubt that investors are profoundly confused about the standards of conduct among those who give them investment advice and naturally assume—contrary to fact—that all advisers must act in their best interest.[53]
- In 2013, the SEC's own Investor Advisory Committee supported a broker-dealer fiduciary duty, writing that "the [Commission's] goal should be to eliminate the regulatory gap that allows broker-dealers to offer investment advice without being subject to the same fiduciary duty as other investment advisers."[54]
- Opponents of the rule have never been able to muster valid arguments or evidence to justify the status quo, relying instead on time-worn and unfounded predictions that brokers will suffer upheaval in their business models and investors will lose access to their financial advice—advice that is corrupted by conflicts of interest investors aren't even aware of.

---

50 Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, (Jan. 21, 2011).

51 *Id.* at 108-09.

52 *Id.* at 108, 112.

53 *See* Siegel & Gale, LLC, Results of Investor Focus Group Interviews About Proposed Brokerage Account Disclosures: Report to the Securities and Exchange Commission 2 (Mar. 10, 2005) (finding investors to be "unclear about the distinctions" between investment advisers with a fiduciary duty and broker-dealers without); Angela Hung et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers: Sponsored by the United States Securities and Exchange Commission 89 (2008) (finding investors believe "financial advisors" and "financial consultants" – who are broker-dealer representatives – have the duties of care of investment advisers; investors cannot distinguish between the fiduciary duty and suitability standards; investors expect brokers and advisers alike to act in the investor's best interest); infogroup/ORC, U.S. Investors & The Fiduciary Standard: A National Opinion Survey (Sept. 15, 2010) (finding a majority of investors believe that investment advice was the primary service offered by brokers or equally as important as transaction services; two-thirds of investors mistakenly believe that brokers are held to a fiduciary standard; nine out of ten Americans believe brokers and advisers who provide investment advice should be required to follow the same investor protection rules).

54 Investor Advisory Committee, Recommendation of the Investor Advisory Committee Broker-Dealer Fiduciary Duty (2013), *available at* http://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation-2013.pdf.

**CONCLUSION**

The Temporary Rule must be allowed to lapse, rather than extended for another two years, and the SEC should act forthwith to impose the fiduciary duty on broker-dealers that provide investment advice about securities to their clients.

We hope these comments are helpful in your consideration of the Proposed Rule.

Sincerely,

Dennis M. Kelleher
President & CEO

Stephen W. Hall
Securities Specialist

Todd Phillips
Attorney (Bar Application Pending)

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

dkelleher@bettermarkets.com
shall@bettermarkets.com
tphillips@bettermarkets.com

www.bettermarkets.com