



## Consumer Federation of America

November 2, 2010

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

**Re: File Number 4-606  
Study Regarding Obligations of Brokers, Dealers, and Investment Advisers**

Dear Secretary Murphy:

Recently, the Securities Industry and Financial Markets Association (SIFMA) submitted a report to the Commission purportedly aimed at assessing “the impact of significant changes to the existing standard of care for broker-dealers and investment advisers.” The conclusion of that assessment is that investors would face limited choices, increased costs, and decreased access to services if brokers were held to a fiduciary standard of care when providing personalized investment advice to retail investors. Even a cursory review of the study quickly demonstrates, however, that it offers no reliable analysis to support its conclusions. Indeed, its authors either misunderstand or deliberately misrepresent the effect of imposing a fiduciary duty, invalidating the report’s conclusions. As a result, the Commission cannot make use of this analysis in its study of the impact of a fiduciary duty unless it first obtains the underlying data and conducts its own, objective analysis of that data. If SIFMA is unwilling to provide the underlying data, the Commission has no choice but to discount the study in its entirety.

**1) The report falsely assumes that brokers would be forced to move to a fee-based compensation structure.**

A major conclusion of the impact assessment, that investor choice would be limited, is based on the false claim that brokers could no longer charge commissions if they were held to a fiduciary duty. However, there is simply no basis for this assumption. The Dodd-Frank Act clearly states that charging commissions does not constitute a violation of the fiduciary duty.<sup>1</sup> Moreover, even if Congress were to adopt legislation eliminating the broker-dealer exclusion from the Advisers Act – something that isn’t remotely likely to happen – this would not preclude brokers from charging commissions for their services. While it is true that brokers who charge

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<sup>1</sup> Section 913(g) of the Dodd-Frank Act states, in part, “The receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer.”

fees are required to be regulated under the Advisers Act, the Act does not prohibit the charging of commissions. Many financial planners currently regulated under the Advisers Act do so.<sup>2</sup>

Thus, there is no reason to believe that imposing a fiduciary duty on brokers would narrow investor choice of how to pay for advisory services. On the other hand, requiring better up-front disclosures of costs and conflicts would allow investors to make more informed choices about what compensation method is in their best interest. If investors armed with all the facts truly prefer the commission-based compensation model, brokers will have a strong incentive to preserve that model. However, this basic assumption – that brokers would be forced to adopt fee-based compensation – underlies virtually all of the report’s findings. Because the assumption itself is clearly false, the conclusions reached in the impact assessment are invalid.

**2) The report falsely implies that investors would lose access to municipal and corporate bonds (and that capital formation for corporations and low-cost financing for municipalities could suffer as a result) if brokers were held to a fiduciary duty.**

Because municipal and corporate bonds are sold primarily through principal trades, and because the Advisers Act imposes strict limitations on principal trading, the report assumes that investors would lose access to these bonds if brokers were held to a fiduciary duty. However, taken at its face value, the limited data that the report presents on this point would appear to directly refute the argument it is intended to support. Specifically, the report notes that 93 percent of corporate and municipal bonds held by low net worth investors and 77 percent of corporate and municipal bonds held by high net worth investors were purchased through commission-based brokerage accounts. The report then makes sweeping inferences about the potential harmful impact on bond sales of subjecting brokers to a fiduciary duty. Put in context, however, the report’s own data suggests that type of account (fee-based vs. commission-based) has little or no impact on investors’ holdings of such securities. Among low net worth investors, roughly 90 percent of assets (compared with 93 percent of corporate and municipal bonds) are held in commission-based accounts, according to the study data. Among high net worth investors, roughly 84 percent of assets (but just 77 percent of municipal and corporate bonds) are held in commission-based accounts. In other words, holdings of municipal bonds are roughly proportional to overall holdings of assets in commission-based and fee-based accounts but somewhat less likely in the commission-based accounts of high net worth investors.

In short, the study shows no deleterious effect on municipal or corporate bonds of fee-based compensation. If one assumes that the fee-based accounts are subject to a fiduciary duty or regulation under the Advisers Act, it further shows that sale of such bonds are readily accommodated under the very conditions SIFMA suggests would unduly restrict their sale. Moreover, it is undeniable that investment advisers and financial planners subject to regulation under the Investment Advisers Act routinely include municipal and corporate debt in their clients’ portfolios, a reality we would expect to see reflected in the SEC’s study.

Finally, the entire principal trading argument is based on the questionable assumption that brokers would be subject to the same restrictions under a fiduciary duty that currently apply

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<sup>2</sup> SIFMA certainly must know both that investment advisers are free to charge commissions and that the Dodd-Frank Act clearly preserves this option. Unaccountably, SIFMA chose to present this impact assessment, based as it is on patently false assumptions and apparently without disclaimer, for consideration as part of the SEC study.

under the Advisers Act. But nothing in the Dodd-Frank Act compels this approach. Indeed, when the Senate addressed the issue in an earlier draft of the legislation, it adopted the entirely different approach of permitting principal trading subject to appropriate disclosures and procedures designed to ensure that the trades are in investors' best interests. To the degree that there is any concern about the impact of a fiduciary duty on sale of municipal and corporate bonds – or other securities sold primarily through principal trades – those concerns could easily be addressed through such an approach.

### **3) The study presents unsupported and highly questionable cost figures.**

The report's "analysis" of additional compliance costs that a fiduciary duty would impose is so incoherent as to defy objective evaluation. In none of its estimates does the report provide a break-out of costs it attributes to the imposition of a fiduciary duty, nor does it present hard numbers that could be analyzed objectively. It is impossible to tell, for example, whether its estimates for commission-based accounts include markups and markdowns on principal trades. If not, that is a glaring omission. The report's conclusion, that brokers would have to hire an army of tens of thousands solely to comply with the same fiduciary duty that has applied to profitable investment advisory and financial planning firms for decades, is preposterous on its face. Given the false assumptions, mischaracterizations, and bias that pervade the report, the report's estimates should be given no credence by the SEC.

Based on what can be analyzed in the report's otherwise opaque cost estimates, the study clearly incorporates a number of false assumptions that go beyond the pervasive misrepresentation that imposition of a fiduciary duty would result in "a broad shift to fee-based" compensation. For example, it includes in the added cost column a number of factors that are already required of brokers under existing suitability, know your customer, and just and equitable trade practices rules. These include: conducting an initial client consultation, including a review of the client relationship and formal consent to the investment strategy employed; evaluating the investor's portfolio; assessing investment objectives; agreeing on the client's investment plan; and documenting client discussions. In addition, the study states that imposing a fiduciary duty would result in added costs for on-going account surveillance. But any such costs would only apply if the broker offered ongoing account management and then would apply regardless of whether the broker was subject to a fiduciary duty or suitability standard. The Dodd-Frank Act is quite clear in stating that it would not impose an ongoing duty of care where there is no ongoing advice.<sup>3</sup>

It will be essential for the Commission, when it drafts its report, to clearly distinguish costs such as these that would not arise from a fiduciary duty because they are already obligations under broker-dealer regulation. In addition, the Commission must attempt to assess the cost savings that could flow to investors from the heightened attention to costs in making recommendations under a fiduciary duty over that which has traditionally been required under a suitability standard. While this is a challenging analysis to conduct, any assessment of the

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<sup>3</sup> It is true that producing and mailing of additional disclosures required by a fiduciary duty could indeed impose additional costs, as the report suggests. Even here, however, FINRA has recently announced that it is looking to proceed with rules in this area, regardless of whether the SEC moves forward with imposition of a fiduciary duty. It is not clear, therefore, that even this otherwise legitimate cost should reasonably be assumed to be an added cost that would arise only with imposition of a fiduciary duty.

impact of a fiduciary duty would be incomplete without it. It perhaps goes without saying that this impact is not addressed in the SIFMA study.

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We have not attempted here to analyze every short-coming in this report.<sup>4</sup> Nor do we intend to suggest that there would be no cost impact of imposing a fiduciary duty on brokers. Rather, our point is that, because its “analysis” is incomplete, one-sided, and based on fundamental misrepresentations of the effect of imposing a fiduciary duty, this report does not add any insight into those impacts. For the SEC to make use of this report, therefore, it would need to obtain the underlying data, compare it with comparable data for advisory firms, and provide its own objective analysis of the implications of that data for policy options that are actually under consideration. But that, by itself, would not be enough.

In drafting its own report, the Commission has an obligation to set the record straight on these and other misleading arguments used by industry members seeking to avoid application of a fiduciary duty to their advisory activities. Toward that end, the Commission must make clear:

- that it is false to state that commissions cannot be charged consistent with a fiduciary duty and regulation under the Advisers Act;
- that it is false to state that a fiduciary duty or regulation under the Advisers Act prevents the sale of proprietary products;
- that it is false to state that the “solely in the interest” standard applied to retirement accounts under ERISA is the standard applied under the Advisers Act’s fiduciary duty;
- that it is false to state that the fiduciary duty or regulation under the Advisers Act automatically imposes a duty to provide “ongoing account surveillance;” and
- that it is false to state that brokers who are not subject to a fiduciary duty are nonetheless subject to a “best interest” standard as opposed to a suitability standard.

Only in this way can the Commission fulfill its obligation to write an objective analysis of the policy options before it as it seeks to raise the standard of care that applies to brokers when they provide personalized investment advice to retail investors.

Respectfully submitted,

Barbara Roper  
Director of Investor Protection

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<sup>4</sup> For example, the report suggests that it is based on a representative sample of firms, but the firms are not identified, so it is impossible to objectively assess the accuracy of that characterization. Moreover, the sample size (16 firms) is quite small, suggesting that it is far from representative. The discussion of the Markets in Financial Instruments Directive (MiFID) appears to be entirely unrelated to the issues addressed in the fiduciary duty study and includes no evidence that MiFID has increased investor costs or reduced investor access to products and services.