NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.
750 First Street N.E., Suite 1140
Washington, D.C. 20002
202/737-0900
Fax: 202/783-3571
www.nasaa.org

NASAA

August 30, 2010

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

Re: NASAA Comments Regarding Obligations of Brokers, Dealers, and Investment Advisers
Release No. 34-62577; IA-3058; File No. 4-606

Dear Ms. Murphy:

The North American Securities Administrators Association, Inc. ("NASAA")[1] appreciates the opportunity to comment and to work with the Securities and Exchange Commission ("Commission") in response to your Request for Comment regarding Obligations of Brokers, Dealers, and Investment Advisers and the Congressional call for a study of the same. With Section 913, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Act") gives the Commission unprecedented rulemaking opportunities to achieve both the Commission's and NASAA's overarching goal - "putting investors first."

Among the various studies included in the Dodd-Frank Wall Street Reform and Consumer Protection Act, the study contained in Section 913 will have the most impact on retail investors. For the reasons stated below, we believe that the standard applicable to persons providing investment advice should be the fiduciary duty currently applicable to investment advisers under the 1940 Investment Advisers Act, that the current regulatory regime is effective, and that arguments by industry in opposition to the fiduciary standard are hollow, especially given the various concessions contained in the bill.

[1] NASAA is the association of all state, provincial, and territorial securities regulators in North America. Its membership consists of the securities regulators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico. Their core mission is protecting investors from fraud and abuse in the offer and sale of securities. Organized in 1919, NASAA is the oldest international organization devoted to investor protection.

I. Fiduciary duty should be extended to Broker-Dealers providing personalized investment advice.

The current standard of care for Broker-Dealers, the "suitability standard," represents a material gap or shortcoming in the regulation of the financial markets and its participants. Unlike Investment Advisers, Broker-Dealers are not required to place investor interests ahead of their own. They are shielded by the suitability standard from requirements to disclose to investors critical features of the investments they sell, including costs, and any conflicts of interest associated with any given purchase. When receiving investment advice, investors deserve and should be afforded the same level of protection and care no matter which type of securities professional they engage. NASAA therefore strongly urges the Commission to close that gap and fulfill Congressional intent by extending the fiduciary standard of care under the Investment Advisers Act of 1940 ("1940 Act") to all financial professionals who provide personalized investment advice to retail clients.

As Chairman Schapiro noted in her July 27, 2010 speech before the Center for Capital Markets Competitiveness[2], "quite different regulatory regimes surround the same activity for the two different registration categories. Until now, duty to the customer has flowed from the perspective and legal regimes of the adviser or broker, not from the perspective of the investor we are seeking to protect." Indeed, as the brokerage business has evolved to include more advisory activities, having two separate and differing standards governing the provision of investment advice no longer makes sense. As the Rand Corporation's Final Report on practices in the investment adviser and Broker-Dealer industries released on January 3, 2008[3] makes clear, the investing public is confused about the distinctions between Broker-Dealers and Investment Advisers, mistakenly believing Broker-Dealers already act as fiduciaries.

The foundation of the fiduciary standard is the requirement that advisers put the interests of their clients before their own. The evidence from the Senate's Permanent Subcommittee on Investigations revealed that Goldman Sachs repeatedly put its own interests and profits ahead of the interests of its institutional clients.[4] Retail investors are often subject to similar abusive practices when they receive investment advice from agents who recommend a security because of higher commissions or revenue sharing payments with their firm or a third party. The Dodd-Frank Act affords the Commission the opportunity to close this longstanding gap between investor expectations and practical reality.

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[2] Available at http://www.sec.gov/news/speech/2010/spch072710mls.htm

[3] Available at http://www.sec.gov/news/press/2008/2008-1_randInvestment AdviserBroker Dealerreport.pdf

[4] *Wall Street and the Financial Crisis: The Role of Investment Banks, 2010: Hearings Examining the Causes and Consequences of the Recent Financial Crisis, Before the U.S. Senate Permanent Subcommittee on Investigations, Homeland Security and Governmental Affairs Committee, 111th Cong., 2nd Sess. (2010)*

The superiority of the fiduciary standard was further underscored in a hearing before the House Financial Services Committee on October 6, 2009.[5] During this hearing, numerous witnesses, including NASAA's President, testified that the fiduciary standard of care under the Investment Advisers Act of 1940 was indeed a higher standard of care and that its application to Broker-Dealers would accomplish the dual mission of eliminating investor confusion and enhancing investor protection for retail investors - those investors who stand to lose the most under a lesser standard of care and remained perplexed when informed that their broker is not required to put their interests first.

Although the lines between services provided by Broker-Dealers and Investment Advisers have blurred over the years, due in large part to Broker-Dealers marketing themselves as "trusted advisors," substantial differences remain, and any regulation promulgated by the Commission should take these differences into consideration. In drafting Section 913 of the Act, Congress itself recognized these differences and included provisions within the legislation to address the different business operations. For example, the industry has expressed concerns about the continued viability of a commission-based compensation model. The Act, however, explicitly states that charging for commissions will not in and of itself constitute a violation. The Act expressly recognizes the need for flexibility in compensation arrangements. In addition, many in the brokerage industry express concern that imposing a fiduciary duty standard will result in the loss of options for investors and drive up the costs of services. Given the concessions in the legislation regarding certain business practices, this argument is specious at best.[6]

Finally, the Commission's adoption of a fiduciary duty for Broker-Dealers and their agents will be consistent with the Department of Labor's reasonably similar proposed fiduciary duty rule aimed at eliminating conflicts of interest applicable to all investment professionals, including brokers, who give advice concerning 401(k) plans and who earn commissions from companies whose products are held in retirement accounts.[7] Although NASAA believes that a list-based approach is inappropriate for a test that was intended to be a judged by the particular facts and circumstances in each case, we believe that all investment professionals providing investment advice about securities should be subject to the fiduciary duty standard under the 1940 Act.

II. State and federal regulation of Broker-Dealers, Investment Advisers, and associated entities is effective.

NASAA welcomes the opportunity to present the state perspective regarding the part of the Section 913 study that examines regulatory resources and effectiveness with respect to Broker-Dealers, Investment Advisers, and persons associated with them in providing

[5] *Capital Markets Regulatory Reform: Strengthening Investor Protection, Enhancing Oversight of Private Pools of Capital, and Creating a National Insurance Office, 2009: Hearings on Strengthening Investor Protection Before the House Financial Services Committee*, 111th Cong., 1st Sess. 84 (2009)

[6] See Section 913 [exceptions for limited menu of products, commissions, and no ongoing fiduciary duty following transaction in which advice was given].

[7] 29 C.F.R. §2550.404c-5 (2010)

services to investors. Like the Commission, the states direct significant resources to regulating, examining, and enforcing the applicable standards of care. The states also devote considerable attention and resources to detecting unregistered activity occurring in their states and bringing enforcement actions against both registered and non-registered persons.

In the Investment Adviser arena, the states are the sole regulator over smaller firms and Investment Adviser representatives and are exceptionally effective in that role. In recognition of the states' exemplary record of accomplishment in this area, Section 410 of the Act recently expanded the states' authority to include a larger percentage of the Investment Adviser population. In less than a year, the states will assume responsibility for regulating most Investment Advisers with up to $100 million in investor assets under management, an estimated 19,000 firms or approximately 75 percent of all registrants.

NASAA actively supported Section 410 of the Act based on the states' firm belief that the new distribution of firms will significantly enhance the effectiveness of Investment Adviser regulation at both the state and federal level. Approximately 4,000 additional Investment Adviser firms will now fall in place with other smaller firms already regulated by the states. The Commission will now be free to focus its resources on the larger, more complex firms. Investors and industry will be better served and investors across the nation will be better protected as the result of this one change.

In the Broker-Dealer arena, the states collaborate with the Commission and the Financial Industry Regulatory Authority ("FINRA") to ensure that registrants are carefully and regularly examined for both basic compliance and anti-fraud purposes. The states have conformed their Broker-Dealer regulations and record keeping requirements to federal law as required by the National Securities Markets Improvement Act of 1996 ("NSMIA"), and devote significant resources to examining and monitoring the activities of the Broker-Dealers, particularly their branch and remote offices. There is no request regarding a state-registered Investment Adviser or Broker-Dealer to which the states will not promptly and capably respond.

With respect to both Investment Adviser and Broker-Dealer regulation, states use extensive and uniform examination tools, a number of the IA exam modules, particularly those related to dishonest and unethical practices rules, are specifically targeted to test compliance with the fiduciary duty standard. State securities regulators also develop and participate in training at many levels and have the resources and support of their sister states and their membership association, NASAA. These methodologies, along with those highlighted below, make the states highly effective in determining compliance with all applicable securities laws and regulations.

Further, states are better positioned to ensure investor protection proactively because of our all-important background checks of Investment Adviser representatives. Such background checks serve a dual function: to provide investors with assurances that their Investment Adviser representatives are free from violations of that law and that potential problems with bad actors do not have the opportunity to reach fruition. Neither the Commission nor FINRA can perform this vital function. This is because neither the Commission nor FINRA register Investment Adviser representatives.

Resources. The states devote significant resources in terms of registration, licensing, and examination staff to Broker-Dealer and Investment Adviser regulation. They, like the Commission, believe their employees are their most vital strategic resource. A number of states are seeking to increase their staffing and resources in response to the additional responsibilities bestowed upon them by the Act. All fifty states have agreed through a formal memorandum of understanding to work together and share resources as needed to regulate the state Investment Adviser population. Through NASAA, the states have the benefit of sophisticated training programs and technological tools to assist their licensing and examination staffs in fulfilling their examination responsibilities.

Performance. The examination process at the state level typically begins before an entity ever becomes a registrant. State securities regulators, using standard forms, review information submitted by applicants to determine whether the applicant satisfies the state's registration requirements. This examination includes an evaluation of the applicant's history as disclosed on the Forms BD and ADV, which are periodically updated by the registrant. The states continually review and monitor registrant activity to assess whether registrants remain qualified to do business in their state.

States monitor ongoing compliance in a variety of ways including, but not limited to, post-visitation reviews, annual questionnaires, and both on and off-site examinations. On-site examinations are performed on routine and for-cause bases. For Investment Advisers, routine exams commonly occur within a 3-5 year examination cycle. A typical state examination will require a day or two of preparation reviewing information on file as well as some preliminary investigation; at least one full day on-site at the licensee's place of business, with two weeks or more analyzing all data collected and preparing a report.

Presence. States have offices in every state, which gives them unparalleled geographic distribution and proximity to the industries and constituents they serve. As compared to both the Commission and FINRA whose national scopes necessitate limited office placement, the state securities regulator's immediate physical proximity ensures accessibility in every community. Further, this proximity results in a significant benefit as regards savings to taxpayers, eliminating the necessity for travel to geographically dispersed locations while providing much needed coverage of areas that would otherwise be underserved. These locations, where both registrants and victims are often located, are often in suburban or rural areas and located far from a headquarters, branch, or regional office. As a result, these locations and victims are underserved by the Commission due to its national focus. State securities regulators provide full coverage of these areas at no cost to federal taxpayers. From preregistration screenings to formal outreach initiatives to registrants, state regulators go far beyond the onsite examination in interacting with their registrants.

Familiarity and Investor Education. As residents of the states they serve, state securities regulators are aware of regional demographics, income levels, local economy and trends, education levels, and local affinity groups in their communities. States also perform extensive outreach and education directly to investors, often one-on-one in person meetings and events that may not be feasible for a regulator with national responsibility.

Combined, the states' intimate familiarity with investors and outreach efforts create a unique level of trust between the state regulator and main street investors.

Accountability. State securities agencies often fall under the jurisdiction of elected officials. There is little barrier, whether geographic or bureaucratic, between the agency and the grass-roots investor or registrants. This heightened level of accountability results in the greatest degree of responsiveness, attentiveness, and commitment on the part of the local regulator to even the smallest advisory firm or individual customer. As a result, state regulators are regarded as the "local securities cop on the beat" who promptly respond to all calls.

The states recognize and laud the advances and reforms that the Commission has made over the past two years. One of the most important steps the Commission has taken to date has been to restructure and increase its staffing in order to respond to the challenges it faces. The states are encouraged by the Commission's recruiting efforts and creation of new specialized units that will enhance the overall effectiveness of its Broker-Dealer and Investment Adviser examination program.

The Commission has also made great strides in rulemaking, most notably, the new custody rule that will better protect Investment Adviser clients from theft and abuse. There is no question that working together, the states and the Commission operating under Chairman Schapiro's leadership can, and will effectively regulate Broker-Dealers and Investment Advisers in the future.

III. Benefits of extending the fiduciary duty will outweigh any potential costs.

Arguing that putting investors first will somehow be prohibitively expensive for firms is a dubious assertion. As noted herein, there is significant overlap in the population of firms and individuals registered under both state and federal investment adviser and Broker-Dealer laws. Second, the Dodd-Frank legislation contains a significant number of concessions that will enable firms to continue to offer discount or sales only activities to individual investors. Third, although it is not contemplated in the legislation passed by Congress, NASAA anticipates that the elimination of the broker and dealer exclusion from the definition of "investment adviser" under section 202(a)(11)(C) of the 1940 Act would not have a deleterious impact on either Commission or state resources to conduct examinations or to enforce the applicable standard of care. The Commission and the states already regulate both Broker-Dealers and Investment Advisers and that will not change whether the exclusion remains or is eliminated. Moreover, there are approximately 250,000 individuals who are currently licensed with the states both as an Investment Adviser representative and a registered representative of a Broker-Dealer.

Adopting one common standard of care will simplify matters in many respects. At most, elimination of the exclusion could increase the number of state-registered Investment Advisers for those brokers and dealers managing up to $100 million in investor assets under management. The states welcome this responsibility. The states believe that if there is any concomitant increase in compliance costs incurred as the result of subjecting Broker-Dealers to a fiduciary duty standard, it will be *de minimus*. The direct benefits to investors from adopting this standard will greatly exceed any foreseeable costs. The states look forward to working cooperatively with the Commission to respond to any challenges the industry may face.

NASAA appreciates this opportunity to comment and to contribute to the Study, and looks forward to working with the Commission in the future.

Should you have any questions regarding these comments, please contact the undersigned or Rex Staples, NASAA's General Counsel at rs@nasaa.org.

Sincerely,

Denise Voigt Crawford
NASAA President
Texas Securities Commissioner

David Massey
NASAA President – Elect
North Carolina Deputy Securities Administrator

Cc: Chairman Mary Schapiro
Commissioner Luis Aguilar
Commissioner Kathleen Casey
Commissioner Troy Paredes
Commissioner Elisse Walter
Sen. Christopher Dodd, Chairman, Committee on Banking, Housing and Urban Development, U.S. Senate
Sen. Richard Shelby, Ranking Member, Committee on Banking, Housing and Urban Development, U.S. Senate
Sen. Jack Reed, Chairman, Securities, Insurance, and Investment Subcommittee, U.S. Senate
Sen. Jim Bunning, Ranking Member, Securities, Insurance, and Investment Subcommittee, U.S. Senate
Rep. Barney Frank, Chairman, Financial Services Committee, U.S. House of Representatives
Rep. Spencer Bachus, Ranking Member, Financial Services Committee, U.S. House of Representatives
Rep. Paul Kanjorski, Chairman, Capital Markets, Insurance, and Government-Sponsored Enterprises Subcommittee, U.S. House of Representatives
Rep. Scott Garrett, Ranking Member, Capital Markets, Insurance, and Government-Sponsored Enterprises Subcommittee, U.S. House of Representatives