NASAA

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

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Via electronic submission to rule-comments@sec.gov

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

Re: Framework for Rulemaking under Section 913 of the Dodd-Frank Act; Duties of Brokers, Dealers and Investment Advisers; File No. 4-606.

Dear Ms. Murphy:

The North American Securities Administrators Association, Inc. ("NASAA")[1] welcomes the opportunity to comment and work with the Securities and Exchange Commission ("Commission" or "SEC") as it undertakes the task of drafting rules that would extend the fiduciary duty standard of care currently applicable to investment advisers to broker-dealers, as provided in Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[2] The following comments respond to the Commission's Request for data and other information, issued on March 1, 2013, entitled *Duties of Brokers, Dealers and Investment Advisers* ("Request for Information" or "RFI").[3] We appreciate the Commission's efforts to obtain data in addition to the information previously collected by the staff in its comprehensive *Study on Investment Advisers and Broker-Dealers* ("the Study" or "the Section 913 Study"), but also note that qualitative information remains an important part of understanding the overall benefits of the fiduciary standard of care. As state securities regulators, we have long-standing experience in applying the fiduciary standard of care in investment adviser oversight and look forward to working with the Commission in developing an approach to implementing the requirements of Section 913 that achieves the goal of "putting investors first." NASAA expects to also comment in response to any future Commission

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[1] NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as the forum for these regulators to work with each other in an effort to protect investors at the grassroots level and to promote fair and open capital markets.
[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
[3] SEC Rel. No. 34-69013, 2013 WL 771910 (Mar. 1, 2013); 78 Fed. Reg. 14848 (Mar. 7, 2012).

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rulemaking in connection with the extension of fiduciary duty to broker-dealers, as well as in response to follow-up guidance that the Commission may issue after rulemaking.

NASAA Supports The Extension of the Fiduciary Duty Standard of Care to Broker-Dealers Through a Uniform Fiduciary Standard of Conduct No Less Stringent Than the Standard Derived from Advisers Act Sections 206(1) and 206(2).

Broker-dealers must be held to the fiduciary duty standard of care currently applicable to investment advisers and be required to place retail investor interests ahead of their own. NASAA believes that retail investor interests are compromised because broker-dealers and investment advisers are currently subject to different standards under federal law when providing investment advice about securities. Therefore, NASAA is pleased that Section 913 speaks to extending a standard of care to broker-dealers that is no less stringent than the standard applicable to investment advisers under Section 206(1) and (2) of the Investment Advisers Act of 1940.[4]

The fiduciary duty standard of care is an effective standard because it reflects investor expectations and is already used by state and federal regulators. NASAA generally agrees with the approach taken in the Section 913 Study, which recommended the implementation of the standard as dictated by the statute and concluded that current guidance, interpretive materials and case law should also apply, as NASAA believes that, in order to satisfy the "no less stringent" mandate of the statute, existing guidance and case law must apply. Drawing from the well-established law and interpretations under Section 206, while making only minimal necessary adjustments when applying the framework to broker-dealers, will result in effective implementation, fewer judicial and legal uncertainties, and, generally, a more seamless transition as compared to working toward any sort of newly articulated or created standard.

While NASAA is pleased that the Commission has continued to work toward implementing Section 913, we are concerned about the RFI's implications that any uniform fiduciary standard considered by the Commission may result in lowering the standard of care currently applicable to investment advisers to a "hybrid" standard drawing heavily from the suitability standard under which the broker-dealer industry currently operates. The suitability standard, even if enhanced with certain additional disclosures, does not provide adequate investor protection for retail customers. Section 913 requires clarification of the Section 206 fiduciary standard in terms of application to broker-dealers, but does not require creation of a new "federal fiduciary standard for broker-dealers" nor does it require a new standard for investment advisers, as the RFI implies.[5]

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[4] Dodd-Frank, § 913(g).
[5] *See* Letter from Joyce A. Rogers, AARP; Barry C. Melancon, AICPA; Barbara Roper, CFA; Kevin R. Keller, CFP Board; Michael Branham, Financial Planning Association; Mercer Bullard, Fund Democracy, Inc.; David G. Tittsworth, IAA; Lauren Locker, NAPFA; and A. Heath Abshure, NASAA (June 4, 2013), *available at* http://www.sec.gov/comments/4-606/4606-3063.pdf.

Extending the fiduciary duty standard to broker-dealers would reflect the evolution in the delivery of financial advice to customers, where broker-dealers are acting as *de facto* investment advisers to retail customers. As is the case with any significant regulatory change, there will be an adjustment period for the broker-dealer industry. Furthermore, the case law and regulatory history under Advisers Act Sections 206(1) and (2) will need to be applied to broker-dealers judiciously to ensure that case law and regulatory history speaking to business practices carved out by the statute (permission to sell proprietary products and limited application of continuing duty of care) is appropriately incorporated into the uniform fiduciary standard of conduct. NASAA supports providing guidance for application of this standard to broker-dealers, but notes that Commission guidance on implementation should not equal a rules-based approach to extending the fiduciary duty standard to broker-dealers.

The fiduciary duty standard is a facts-and-circumstances standard, which makes it inherently flexible to apply to a variety of business models. A highly prescriptive approach would undermine the flexibility of the standard as applied to the particular responsibilities a broker-dealer may undertake. To ensure that investors receive the benefit of the uniform fiduciary standard of care, any adjustments in response to the broker-dealer industry should be minimal. It is the broker-dealer industry practices that must change where necessary to comply with the standard and not the other way round. Any other approach to extending the fiduciary duty standard of care to broker-dealers would fail to meet the congressional mandate of Section 913 and fail to reflect retail customer expectations and assumptions with regard to their receipt of personalized investment advice about securities provided by their broker-dealers.

We discuss below the importance of the Commission revising its assumptions as explained in the RFI as revision of these assumptions is vital to ensure that the uniform fiduciary standard of conduct provides adequate investor protection. Where applicable, we have provided additional information on understanding retail investors, the investor confusion that has resulted from the broker-dealer industry's marketing practices, and a discussion on remedies and investor protection. Finally, we discuss the reasonable and workable approach that the Section 913 Study described in 2011 and encourage the Commission to look to the Study to define and apply the uniform fiduciary standard.

The Commission Must Revise Its Assumptions To Ensure That The Uniform Fiduciary Standard of Conduct Provides Adequate Investor Protection.

As noted above, we are concerned that the Commission may be considering lowering the standard of care for investment advisers, as the assumptions[6] listed and described in *II.A. Initial Clarification and Assumptions* of the RFI appear to indicate. NASAA outlines these concerns regarding each of the eight assumptions below, noting that the RFI indicates assumptions that would fail to meet the Congressional intent of Section 913 specifically and investor protection goals generally. Specifically, NASAA recommends: (1) the definition of "personalized investment advice" be broader than recommendations-based advice; (2) the Commission consider extending fiduciary duty to relationships other than broker-dealer relationships with *retail* customers; (3) the Commission adopt a uniform fiduciary standard that does not lessen the

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[6] *See* RFI, 78 Fed. Reg. at 14854-14855.

existing fiduciary duty standard applicable to SEC-registered investment advisers; (4) maintaining prohibitions on certain compensation-related conflicts; (5) the uniform fiduciary standard only include limited exceptions from the continuous duties of care and loyalty; (6) the proprietary product exception only apply to broker-dealers; (7) the Commission consider SEC Rule 206(3)-3T as part of fiduciary standard rulemaking; and (8) the uniform fiduciary standard of care must supplement FINRA's suitability requirements.

1. The Commission should define "personalized investment advice" to include advice beyond recommendations-based advice.

NASAA believes that "personalized investment advice" should be defined broadly enough for the duty of care to attach when the relationship commences, not when transactions commence in the customer's account. Therefore, NASAA is concerned the Commission's assumption for "personalized investment advice" (Assumption #1)[7] fails to include advice surrounding account opening and does not capture all personalized investment advice that should be covered by the uniform fiduciary standard. There is language in the RFI's assumption that "personalized investment advice" should extend beyond what constitutes a recommendation under broker-dealer regulation to include any other actions or communications that constitute investment advice under the Advisers Act. However, the RFI then cites asset allocation and comparisons of securities as examples of such other investment advice, but fails to address advice surrounding account opening. NASAA urges the Commission to consider broadening the term "personalized investment advice" to include advice surrounding account opening, including advice about the types of accounts under consideration.

Account opening is a crucial opportunity for a firm to ensure that the customer understands the relationship, the type of account, and the longer term strategy. A broker-dealer representative may provide advice about securities as part of the account opening discussions which, therefore, should be considered personal investment advice.[8] For example, a customer may receive advice about the various types of accounts available to customers, including the differences between these accounts with regard to commissions, tax consequences, and fee structure. Such a retroactive application of the standard of conduct is analogous to the attorney-client confidentiality and privilege rules in the majority of states, where discussions leading up to the decision of a client to retain an attorney are nevertheless covered by obligations of confidentiality and privilege. Therefore, NASAA believes that personalized investment advice should also include the advice provided to the customer as part of the account opening process to ensure that the uniform fiduciary standard of conduct attaches at that point in the relationship, and urges the Commission to reconsider this assumption.

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[7] *See* RFI, 78 Fed. Reg. at 14854.

[8] *See* Carlo di Florio, Director, Office of Compliance Inspections and Examinations, *Conflicts of Interest and Risk Governance*, Address to the National Society of Compliance Professionals (October 22, 2012), *available at* http://www.sec.gov/news/speech/2012/spch103112cvd.htm.

2. The Commission should consider extending fiduciary duty to broker-dealer / customer relationships other than solely broker-dealer relationships with *retail* customers.

The uniform fiduciary standard of care should extend to all retail customer relationships maintained by broker-dealers and that, as part of rulemaking, the Commission should also consider extending the standard of care to additional customer relationships that broker-dealers maintain. We are concerned that in Assumption #2[9] the Commission prematurely truncates the applicability of the uniform fiduciary standard of conduct to retail customer relationships, without exploring additional applications of the standard through rulemaking. Section 913 specifically states that the Commission has the authority to commence rulemaking "for the protection of 'retail customers' ***(and such other customers as the Commission may by rule provide)***" (emphasis added) and we would encourage the Commission to consider the implications of extending the duty beyond retail customers.[10]

Congress created Section 913 to achieve increased protection of investors through a heightened standard of care and defined "retail investor" as part of the statute, but Section 913(f) also grants the Commission the discretion to promulgate standard of conduct rules to "such other customers" beyond retail investors, "as the Commission may by rule provide."[11] We are concerned that the Commission is prematurely curtailing the scope of the rulemaking exercise and missing an opportunity, at a minimum, to explore the benefits of applying the uniform fiduciary standard to additional customer relationships that broker-dealers maintain such as relationships with the owners of small businesses.

3. Adoption of a uniform fiduciary standard of conduct must not lessen the fiduciary duty standard currently applicable to SEC-registered investment advisers.

Any exercise in creating a uniform fiduciary standard must not dilute or otherwise diminish the existing fiduciary duty of care currently applicable to SEC-registered advisers. Such an approach is contrary to investor protection and the intent behind Section 913. Therefore, we are especially concerned about the RFI's Assumption #3, "any actions would apply to all SEC-registered broker-dealers and SEC-registered investment advisers,"[12] as it implies the creation of a new standard of care for investment advisers. We are also concerned that Assumption #3 contemplates extending Section 913's limited exceptions for systematic application to all broker-dealer and investment adviser relationships. Congressional intent is clear: while Section 913 requires clarification of the Section 206 fiduciary standard in terms of application to broker-dealers, including limited exceptions, it does not require creation of a new "federal fiduciary standard for broker-dealers" nor the creation of a new standard for investment advisers. Congress determined in Section 913 that the standard of care for broker-dealers should be *raised* to the fiduciary duty standard of care applicable to advisers due in part to the focus in broker-dealer marketing campaigns on the advisory services and relationships they provide. Advice in the context of broker-dealer marketing is no longer an "incidental" aspect of the client

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[9] *See* RFI, 78 Fed. Reg. at 14854.
[10] Dodd-Frank, § 913(f).
[11] *Id*.
[12] Assumption #3. *See* RFI, 78 Fed. Reg. at 14854.

relationship and, therefore, the goal of the Commission in implementing Section 913 should be to align the standard applicable to broker-dealers with that of an advisory relationship versus a sales relationship.

At such time that the Commission initiates the rulemaking process pursuant to Section 913, the agency must hew to the intent of Section 913 by extending a standard of care no less stringent than the standard under the Advisers Act Sections 206(1) and (2) and apply the uniform fiduciary standard to supplement, rather than replace, existing regulatory frameworks. As noted in the Section 913 Study, "the uniform fiduciary standard would be an overlay on top of the existing investment adviser and broker-dealer regimes and would supplement them, and not supplant them."[13] Furthermore, in the Section 913 Study, Commission staff concluded that current guidance, interpretive materials and case law should also apply,[14] which is especially important to ensure that the "no less stringent than" mandate of Section 913 is met.

4. Disclosures for compensation-related conflicts of interests must not supplant the prohibition of certain compensation-related conflicts.

The fiduciary duty standard is not exclusively a conflicts disclosure regime and firms should not be allowed to "disclose away" all conflicts of interest under the uniform fiduciary standard. While disclosing and managing conflicts of interest is a component of fiduciary duty, the standard also contemplates conflicts that cannot be disclosed and are therefore prohibited. NASAA is concerned with the implications of the RFI's Assumption #4, which requires "at a minimum a broker-dealer or investment adviser would need to disclose material conflicts of interest, if any, presented by its compensation structure."[15] NASAA is especially concerned by the implication that all compensation-related conflicts of interest can be cured through disclosure, while also concerned that the Commission may interpret Section 913 to allow broker-dealers to make principal trades under a uniform fiduciary standard of care, without articulating the importance for guidance.[16]

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[13] Dodd-Frank, § 913 Study at 109.
[14] Dodd-Frank, § 913 Study at 107 and 110:

> Therefore, in the interests of increasing investor protection and reducing investor confusion, the Staff recommends that both broker-dealers and investment advisers should be held to a uniform fiduciary standard in providing personalized investment advice about securities to retail customers that is no less stringent than the existing fiduciary standard of investment advisers under Advisers Act Sections 206(1) and (2). The Staff believes that the uniform fiduciary standard would be consistent with the standard and precedent that apply to investment advisers… [and] existing guidance and precedent under the Advisers Act regarding fiduciary duty, as developed primarily through Commission interpretive pronouncements under the antifraud provisions of the Advisers Act, and through case law and numerous enforcement actions, will continue to apply.

[15] RFI, 78 Fed. Reg. at 14855.
[16] For a discussion on principal trading, please see NASAA's response to RFI Assumption #7, on page 9.

NASAA agrees with the assumption that the uniform fiduciary standard of conduct should be designed to accommodate different business models and fee structures of firms, which requires effective conflicts disclosures. The fiduciary duty regulatory framework recognizes that certain relationships an investment adviser may maintain, such as certain research and soft dollar practices, directed brokerage and commissions, are inherent conflicts of interest, which must be disclosed and managed. These industry practices can occasionally benefit the client by providing additional research and expertise to the investment adviser or a discount on transactions. Nevertheless, there are certain conflicts of interest that cannot be managed through disclosure and therefore must be avoided. These conflicts include an investment adviser that prefers one client over another when managing multiple accounts side-by-side, or a fund adviser that engages in portfolio management activities beyond the risk tolerance or stated objectives of the fund, usually due to financial incentive. NASAA is concerned that Assumption #4 implies that all compensation-related conflicts of interests can be managed through disclosure, such as with soft dollar practices, and fails to acknowledge that there are compensation practices that cannot be managed through disclosure.

5. The uniform fiduciary standard of conduct must only include limited exceptions from the continuous duties of care and loyalty, as mandated by Section 913.

Section 913(g), through the addition of Section 15(k) to the Securities and Exchange Act, does not prescribe the existence of a continuing duty of care in the standard applicable to broker-dealers. Section 913 allows for a continuing duty of care for broker-dealers when the facts and circumstances warrant such a duty. NASAA is therefore very concerned by the Commission's Assumption #5: "the uniform fiduciary standard of conduct would not generally require a broker-dealer or an investment adviser to … have a continuing duty of care or loyalty to a retail customer after providing him or her personalized investment advice about securities."[17] As drafted, the assumption would remove the continuous natures of the duties of care and loyalty from a proposed uniform standard of care, as compared to how those duties are currently applied to investment advisers. This would result in a significant decrease in investor protection. NASAA is particularly concerned as Section 913(g) speaks to a limited exception from the continuous nature of the duties of care and loyalty for *brokers, dealers and their registered representatives*. Assumption #5, in contrast to the exception listed in Section 913(g), implies the Commission is applying this limited exception too broadly.

Congressional mandate with regard to the Section 913(g) exceptions, focuses exclusively on activities that broker-dealers may undertake under a uniform fiduciary duty of conduct, including earning commissions, selling proprietary or other limited range products, or giving episodic investment advice without being automatically subject to a continuing duty of care or loyalty to the customer after providing personalized investment advice. Section 913 amended only the Securities and Exchange of Act of 1934 when providing for these limited exceptions to the uniform fiduciary standard, and the language of each exception speaks only to the activities of brokers and dealers. The Section 913 Study also notes that these exceptions are provisions designed to address concerns from broker-dealers that the uniform fiduciary standard of conduct be "business model-neutral" and preserve investor choices "by preserving commission-based accounts, episodic advice, principal trading and the ability to offer only proprietary products to

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[17] RFI, 78 Fed. Reg. at 14855.

customers."[18] Furthermore, while NASAA acknowledges Congressional intent in connection with episodic investment advice, the Commission should reconsider the broad assumption that the uniform fiduciary standard of conduct would not generally require a broker-dealer or investment adviser to have a continuing duty of loyalty or care.

It is important to apply a continuing duty of care to those broker-dealer relationships that are *de facto* investment advisory relationships in the provision of personalized investment advice about securities to retail customers. Section 913(g)[19] shows recognition that a significant portion of broker-dealer client accounts are *de facto* investment advisory relationships, while other relationships do not rise to such a level. NASAA also recognizes that such a duty should not apply for broker-dealer relationships that include only very limited and incidental personalized investment advice to a retail customer, as can sometimes occur as part of a directed brokerage account relationship.[20] Nevertheless, Section 913's language regarding continuing duty should be read within the context of the statute to allow for a limited exception of the continuing nature of the fiduciary duty of care for certain, select, broker-dealer relationships with retail customers, rather than be considered applicable to all broker-dealer customer relationships. Furthermore, the Section 913 exception from the continuing duties of care and loyalty do not apply to investment advisers, as the exception appears in the Exchange Act only, and refers to brokers, dealers and their registered representatives only.

6. The proprietary product exception must only apply to broker-dealers.

NASAA has expressed concern regarding the sale of proprietary or limited-range products, particularly variable annuities, as these products frequently present sales practice and other investor protection concerns. Assumption #6 indicates that the Commission may consider applying the proprietary product exception to investment advisers as well as broker-dealers. Such an approach is contrary to Section 913. The language of Section 913 is explicit that the exception applies to brokers or dealers.[21] Furthermore, this is an area where the Commission must require robust disclosures to highlight the inherent conflicts of interest presented by the sale of limited range products.

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[18] Dodd-Frank, § 913 Study at 127.

[19] Dodd Frank, § 913(g) states "Nothing in this section shall require a broker or dealer or registered representative to have a continuing duty of care of loyalty to the customer after providing personalized investment advice about securities."

[20] Rather than limit the broker-dealer industry's ability to offer a wide variety of accounts to retail customers, NASAA believes that rulemaking should provide guidance for the limited instances where personalized investment advice is provided on an irregular basis, regarding specific investments, rather than in the context of a long-term strategy. NASAA cautions, however, against broadly defining these instances, and believes that a continuing duty of care should be a default component of the fiduciary standard of care extended to broker-dealers, with guidance in the application of the facts and circumstances allowing for limited exceptions, such as in the instances of self-directed customer trading accounts.

[21] Dodd-Frank, § 913(g).

NASAA has identified problems in the sale of variable annuities as a persistent threat to all retail investors, and especially senior investors.[22] The regulatory and investor protection issues surrounding variable annuities have been documented over the years in regulatory warnings, governmental enforcement actions, private lawsuits, and media accounts.[23] The problematic sales practices surrounding variable annuities include: (1) misrepresentations about the annuities' liquidity; (2) unsuitable sales to customers for whom a variable annuity's long timeline is inappropriate; (3) lack of disclosures about steep surrender charges; (4) lack of disclosures about commission structures; and (5) lack of choices for customers, as firms usually sell only a limited number of variable annuity products. Several state securities regulators have brought actions in matters involving variable annuities. Recurrent themes generally appear in these cases. First, investors are induced to liquidate securities portfolios in order to buy variable annuities, often based on sales pitches that annuities are interchangeable with securities. Second, sales pitches often lead investors to believe that through variable annuities, they are actually investing in traditional securities such as mutual funds.[24]

Variable annuities are a type of proprietary product contemplated by Section 913 in this exception for broker-dealers, which states "the sale of only proprietary or other limited range of products by a broker or dealer shall not and in of itself be considered a violation of the standard set forth in paragraph (1) [uniform standard of care]."[25] In light of the sales practice and other investor protection concerns presented by variable annuities, NASAA is concerned about any rulemaking exercise that could potentially increase the sale of variable annuities or other proprietary products. We note that, as with the exception for continuing duty (see, above, discussion regarding Assumption #5), the exception statutorily mandated is designed solely for *a broker or dealer*, not for investment advisers. NASAA urges the Commission to apply this exception as mandated, solely to broker-dealers, and require extensive disclosures.

7. Broker-dealers must disclose conflicts of interests associated with principal transactions, as is required under Section 206(3) for investment advisers acting as broker-dealers.

NASAA believes that the Section 206(3) prohibition on principal trading is a cornerstone of the fiduciary duty standard of investment advisers, though acknowledges that, if correctly disclosed and managed, principal trading transactions can generally be managed as other manageable conflicts of interest are handled. NASAA is concerned that the Commission has prematurely opined on allowing broker-dealers to continue engaging in principal trading, even when subject to a uniform fiduciary standard of care, as long as broker-dealers disclose their

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[22] *See* NASAA Enforcement Report (Oct. 2012), *available at* http://www.nasaa.org/wp-content/uploads/2012/10/2012-Enforcement-Report-on-2011-Data.pdf; *see also* NASAA Enforcement Report (Oct. 2011), *available at* http://www.nasaa.org/wp-content/uploads/2011/08/2010-Enforcement-Report.pdf.

[23] *See* Comment Letter from Karen Tyler, NASAA President and North Dakota Securities Commissioner regarding the SEC's Proposed Rule That Would Subject Certain Equity-Indexed Annuities to Regulation Under the Federal Securities Laws (Sept. 10, 2008), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/29-NASAA_Comment_Letter_on_SEC_Proposed_Rule_151A.pdf.

[24] *Id.*

[25] Dodd-Frank, § 913(g).

principal trading practices. While Section 913 is silent on the application of Section 206(3) in the context of the uniform fiduciary standard of conduct, the Commission should consider SEC Rule 206(3)-3T as part of future fiduciary standard rulemaking.

Currently, SEC Rule 206(3)-3T allows investment advisers that are also registered as broker-dealers to engage in principal trading in non-discretionary advisory accounts as long as customers provide blanket consents. SEC Rule 206(3)-3T is scheduled to expire on December 31, 2014, absent Commission action. When extending the sunset date to 2014, the Commission noted that deferral on final action on Rule 206(3)-3T in 2010 had occurred in light of Section 913 and the Commission's consideration of the regulatory requirements applicable to broker-dealers and investment advisers, including whether Rule 206(3)-3T should be substantively modified, supplanted or permitted to sunset.[26] The Commission also noted that it adopted the latest extension to 2014 because it continues to consider the issues raised by principal trading, including the restrictions in Section 206(3), part of the Commission's broader considerations of the regulatory requirements applicable to broker-dealers and investment advisers in connection with the Dodd-Frank Act.[27] In light of these Commission pronouncements, NASAA is concerned that in Assumption #4 the Commission has prematurely reached a conclusion on the issue of principal transactions, particularly when read in combination with Assumption #7, which states specifically that a broker-dealer would need to disclose any material conflicts of interest associated with its principal trading practices.

8. The uniform fiduciary standard of care must supplement FINRA's suitability requirements.

A uniform fiduciary standard of conduct, even with limited exceptions to the continuing duty component of the standard, would provide increased investor protection as compared to the current suitability standard used by broker-dealers pursuant to FINRA Rule 2111. NASAA is concerned that Commission rulemaking for the uniform fiduciary standard of conduct will not take into account the interplay of FINRA Rule 2111 and the uniform standard. The requirements of FINRA Rule 2111 can only meet the suitability component of the uniform standard. Furthermore, NASAA is concerned about the perception that the fiduciary standard is an enhanced suitability standard. Even an enhanced suitability standard is not a substitute for the fiduciary duty of care standard, nor is overlaying additional disclosures on a suitability standard a proxy for a fiduciary duty standard of care.

While FINRA Rule 2111 includes elements of a best interests analysis, the newly-interpreted standard fails to include a continuing duty of care. Nevertheless, retail customers remain under the impression that their accounts are subject to the tenets of fiduciary duty and that they have an ongoing relationship with the broker-dealers and their registered representatives. Furthermore, as the highest standard of care available to investors, the fiduciary duty standard is also the most effective, as it provides investors with the comfort and protection they naturally assume of their financial advisory providers, but it is not one that FINRA Rule 2111 provides. Rather, FINRA

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[26] Temporary Rule Regarding Principal Trades with Certain Advisory Clients, SEC Rel. No. 3522, , 2012 WL 6627717 (Dec. 20, 2012); 77 Fed. Reg. 76854 (Dec. 31, 2012). The Adopting Release for the extension of Rule 206(3)-3T also speaks specifically to the Section 913 Study.
[27] *Id.*

Rule 2111, which became effective on July 9, 2012, speaks to suitability requirements in the context of a best interests analysis. Notably, the rule does not apply a continuous duty of care, leaving a gap in investor protection. Though courts and administrative adjudicators have acknowledged that, based on a facts-and-circumstances analysis, broker-dealers can be held to the fiduciary standard for certain customer relationships, extending a fiduciary duty of care standard to broker-dealers that provide personalized investment advice to retail customers is necessary to protect investors.

Understanding Retail Investors: Investor Confusion and Remedies.

State securities regulators focus on the protection of retail investors, whether through responding to customer complaints, investor education, licensing and registration activities or enforcement actions. Retail investors avail themselves of both broker-dealer and investment adviser services, yet have remained confused about standards of care in large part due to broker-dealer marketing practices. We believe that it is vital to investor protection that (1) the Commission anticipate new investor confusion through mandating a plain-English narrative disclosure document for broker-dealers, similar to Form ADV Part 2A currently required of investment advisers and (2) that retail investors must have access to private remedies outside of arbitration.

1. Retail investors avail themselves of investment adviser services.

We are concerned that there is a perception that retail investors do not have access to investment adviser services because of required minimum assets to be eligible to do business with certain advisers. State securities regulators oversee 17,601 investment advisers,[28] which manage assets less than $100 million and are commonly referred to as small to mid-sized investment advisers. Over 14,300 of these advisers indicated on Form ADV that they provide advisory services to retail investment clients, which for purposes of this letter we consider individuals other than high net worth individuals.[29] Therefore over 80% of state registered investment advisers serve retail investment clients. About half of those (or just under 40% of the total state investment adviser registrant population) indicate that 75% and above of their clients are comprised of retail investors. Furthermore, about 80% of state registered investment advisers also indicated that they provide portfolio management services for individuals and/or small businesses. These statistics regarding state-registered investment advisers provide insight into retail clients availing themselves of such services and demonstrate that even when subject to a fiduciary duty these advisers able to serve the needs of investors with smaller sums to invest. We encourage the Commission to perform an analogous analysis of its investment adviser data.

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[28] All statistics as of June 18, 2013.

[29] Form ADV Instructions define a high net worth individual as "an individual who is a 'qualified client under rule 205-3 or the Advisers Act or who is a 'qualified purchaser' as defined in section 2(a)(510(A) of the Investment Company Act of 1940." For purposes of understanding the customers served by investment advisers, we drew from investment advisers compilation data on state-registered investment advisers, as of June 18, 2013, *publicly available at* http://www.adviserinfo.sec.gov/IAPD/Content/BulkFeed/CompilationReports.aspx?ORG_PK=undefined&RGLTR_PK=undefined&STATE_CD=undefined&FLNG_PK=undefined.

2. Investor confusion is an outcome of industry marketing practices.

Investor confusion surrounding the standard of care remains a persistent issue that needs to be addressed. The broker-dealer industry, through its marketing campaigns, has fostered the belief that customers should expect long-term relationships whereby broker-dealers provide personalized financial advice. The broker-dealers are acting as *de facto* investment advisers, without the protection of the fiduciary duty standard of care. Retail investors, however, are generally confused by the differing standards of care and often unaware of the differences between the standards, or the legal implications. Studies have shown that investors do not understand the difference between investment advisers and broker-dealers and the standards applicable to each.[30] NASAA is pleased that the Section 913 Study recognizes the widespread problem of investor confusion and standard of care[31] and that the Commission has acknowledged the disparity as well.[32] The Commission has observed that the lines between broker-dealers and investment advisers have blurred. Partially because of the expectations the industry has set, and partially because of the marketing approach the industry uses – the proverbial financial adviser who is your partner in retirement every step of the way. Ultimately, investor confusion is the symptom, not the underlying issue, but as long as the broker-dealer industry continues to engage in advice driven marketing the confusion will persist.

3. The Commission should anticipate new investor confusion issues through mandating a disclosure document similar to Form ADV Part 2A for broker-dealers as well as investment advisers.

The Commission should consider these well-documented issues of investor confusion as it implements the uniform standard of conduct and anticipate potential new areas of investor confusion. Section 913 mandates certain limited exceptions to the uniform standard of conduct. Implementation of these exceptions could result in additional investor confusion. The Commission should consider requiring all broker-dealers to provide plain-English narrative disclosure documents to their clients (similar to the Form ADV Part 2A document required of SEC-registered and state-registered investment advisers that serve retail clients) that would address differences in the application of the uniform standard of conduct, particularly in connection with how broker-dealers may avail themselves of the limited exceptions.

4. Investors must have access to private remedies outside of arbitration.

NASAA is concerned about the availability of remedies available to investors – especially retail investors – for breach of fiduciary duty, both in the context of broker-dealer / customer and investment adviser / client relationships.[33] The jurisprudence regarding a private right of action

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[30] *See* Rand Institute for Civil Justice, *Investor and Industry Perspectices on Investment Advisers and Broker-Dealers* (2008), *available at* http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf. *See also U.S Investors & The Fiduciary Standard* (2010). a*vailable at* http://www.hastingsgroup.com/fiduciarysurvey/.
[31] *See* Dodd-Frank, § 913 Study at 93 to 101.
[32] *See* 78 Fed. Reg. at 14848-14849.
[33] State securities regulators bring enforcement actions against registered individuals in the context of broker-dealer / customer and investment adviser / client relationships. The most recently released NASAA Enforcement Report (Oct. 2012) indicates that state securities

for breach of fiduciary duty is limited,[34] largely because of mandatory pre-dispute arbitration clauses for broker-dealer / customer relationships[35] and lack of private right of action for damages and other monetary relief under Advisers Act Sections 206(1) and (2). Under the federal securities laws, clients have only a limited private right of action under Advisers Act Section 215 to void an investment adviser's contract and obtain restitution of fees paid. State case law jurisprudence provides remedies for breach of fiduciary duty and demonstrates a range of outcomes based on facts and circumstances.[36] A more immediate concern for NASAA would be the extension of mandatory pre-arbitration clauses in agreements between retail investors and SEC-registered investment advisers.[37] State law jurisprudence for applicability of a fiduciary duty private right of action[38] would become further limited if investment adviser disputes with customers occur in FINRA Dispute Resolution arbitration, such as broker-dealer disputes with customers already occur.

The Advisers Act Section 205(f), added by the Dodd-Frank Act, authorizes the Commission to prohibit or restrict mandatory pre-dispute arbitration provisions in client agreements. In separate correspondence to the Commission NASAA has urged the Commission to undertake rulemaking pursuant to the authority provided in Section 205(f).[39] Nevertheless, the Commission has not proposed or adopted such a rule at this time. NASAA again urges the

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regulators launched hundreds of investigations against registered members of the securities industry. The Report notes that 240 suitability investigations were reported, followed closely by 237 reported investigations into dishonest and unethical practices. States also reported 150 failure-to-supervise investigations as well as dozens of investigations triggered by suspected violations in each of the following categories: books and records; unauthorized trading; selling away; and churning. It is important to note, however, that state enforcement actions, like FINRA and SEC enforcement actions, are only one part of the investor protection framework, and that investors must have access to private remedies.

[34] *See*, *for example*, *Lawarre v. Fifth Third Secs.*, 2012 WL 3834052 (Ohio App. 2012) (a broker or financial advisor has a fiduciary relationship with his clients); *Stokes v. Hensen,* 217 Cal. App. 3d 187, 265 Cal. Rptr. 836 (Cal. App.1990) (Ample evidence to support the finding that a fiduciary relationship existed between an investment adviser and the client. Considerable evidence that the defendant failed to apprise plaintiffs of the risks involved in the venture, in breach of his fiduciary duty to plaintiffs).

[35] *See also* NASAA Issue Focus: Forced Arbitration, *available at* http://www.nasaa.org/issues-and-advocacy/issue-focus/forced-arbitration/.

[36] *See Stokes*. *See also*, *In the Matter of Jerome Markowitz Trust,* to be published in A.3d. Currently, 2013 WL 2253380 (Superior Court of Pennsylvania, May 23, 2013).

[37] *See Bakas v. Ameriprise Financial Services, Inc.*, 651 F. Supp. 997 (D. Minn. 2009); *see also* Section 913 Study at 43-44.

[38] *Contrast Lawarre* with *Brooks v. Key Trust Co. Natl. Assn*., 26 AD3d 628 (N.Y.A.D. 2006) (breach of fiduciary duty claim considered duplicative with breach of contract rescission claim).

[39] *See* Letter from A. Heath Abshure, NASAA President and Arkansas Securities Commissioner, to Mary Jo White, SEC Chair, regarding Mandatory Predispute Arbitration Clauses (May 3, 2013), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Letter-to-SEC-on-Arbitration-and-Class-Action-Waivers.pdf.

Commission to examine remedies for customer pursuant to a uniform fiduciary duty of conduct and look beyond the arbitration framework.

The Commission Should Look to the Commission Staff Section 913 Study to Define and Apply the Uniform Fiduciary Standard.

The Section 913 Study by Commission staff generally set forth a reasonable and workable approach to implementing a uniform fiduciary standard for broker-dealers and SEC-registered investment advisers. Unlike the Commission's assumptions, the Section 913 Study's approach does not contemplate a dilution of the fiduciary duty standard currently applicable to SEC-registered investment advisers. Despite the call from several stakeholders, including industry, that the standard set forth in the Section 913 Study can only be articulated by highly prescribed rules covering every possible scenario that might arise in the relationship between a broker-dealer and her customer, there is no such mandate in the statute. Furthermore, such an approach would not further investor protection and, instead, be a detriment to retail investors.

Rather, the Commission should undertake to promulgate rules that articulate the standard and its general parameters with subsequent guidance, where necessary. In defining the standard, the Commission need look no further than the statute. The standard applicable to broker-dealers and investment advisers when providing personalized investment advice would require that the broker-dealer or investment adviser 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.

NASAA also believes that the application of the fiduciary duty standard at an account level as opposed to a client relationship level should also rest on a facts and circumstances analysis. While NASAA appreciates that account-by-account application may be easier to implement, the question of whether a fiduciary standard applies should not depend simply on the nature of the account, but rather on a facts and circumstances analysis of the discussions that led to the opening of the account.

As noted above, this standard would generally apply to retail customers but the Commission should consider what other such customers might be included as suggested by Congress when it included language that indicated that the duty might apply in relationships with other customers. As to the when the standard applies, the simple fact should be that it applies as determined by the facts and circumstances of the relationship between the customer and the financial professional. A rule proclaiming that the answer to the question of when the standard applies is determined by the contract would only lead to every broker-dealer contract containing a boiler-plate clause that the broker-dealer is not acting as a fiduciary. Such an outcome would subvert the purpose of the standard.

As to what constitutes personalized investment advice, the Section 913 study points to the well-established principles developed under the Advisers Act regarding personalized investment advice. These principles should form the basis for establishing a definition of personalized investment advice that should include information conveyed for the purpose of inducing a customer to hold, buy, or sell a security. Furthermore, as noted above, personalized investment advice should also include advice surrounding account opening, including advice about the types of accounts under consideration.

In closing, the uniform fiduciary standard as applied should not be some form of enhanced suitability standard built around disclosure and consent. The facts and circumstances nature of the duty should be preserved through Commission rulemaking that defines the standard in clear terms with limited exceptions as provided in the statute for proprietary trades and broker-dealers who offer a limited range of products. Further, the limits placed on the continuing duty of care must be grounded in the facts of the customer relationship and not solely a matter of contract. We believe that this approach to the implementation of the fiduciary standard will provide sufficient guidance for broker-dealer firms and heighten the standard of care as intended by Section 913.

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Thank you again for the opportunity to comment on the Commission's initiatives to meet its Section 913 mandate. NASAA believes that retail investor interests are compromised because broker-dealers and investment advisers are subject to different standards under federal law when providing investment advice about securities. Therefore, NASAA considers the extension of the fiduciary duty of care, with limited modifications, to the broker-dealer industry an important step toward the investor protection mandate that the NASAA and the Commission share. Should you have any questions regarding the comments in this letter, please do not hesitate to contact Joseph Brady, NASAA General Counsel, at jb@nasaa.org or 202-737-0900.

Sincerely,

A. Heath Abshure
NASAA President
Arkansas Securities Commissioner