

MEMO# 27116

March 15, 2013

Notice of Committee Conference Call: SEC Requests Data on Possible Fiduciary Duty for Broker-Dealers and IA-BD Harmonization

[27116]

March 15, 2013

TO: BROKER/DEALER ADVISORY COMMITTEE No. 15-13

OPERATIONS COMMITTEE No. 13-13

SALES FORCE MARKETING COMMITTEE No. 2-13 RE: NOTICE OF COMMITTEE CONFERENCE
CALL: SEC REQUESTS DATA ON POSSIBLE FIDUCIARY DUTY FOR BROKER-DEALERS AND IA-
BD HARMONIZATION

As we described in a memorandum circulated broadly to ICI members, [\[1\]](#) the Securities and Exchange Commission has published a request for data and other information to assist it in considering whether to make new rules about the standards of conduct and regulatory obligations for broker-dealers and investment advisers when they provide personalized investment advice about securities to retail customers (the “Consultation”). [\[2\]](#) Comments will be due to the SEC on July 5, 2013, which is 120 days after publication of the Consultation in the Federal Register.

ICI members are invited to participate in a conference call at 11:00 a.m. Eastern on Wednesday, March 27th to discuss the Consultation and ICI’s response. We expect the call to last approximately one hour. Please RSVP to raquel.canales@ici.org in order to receive the dial-in information.

For the sake of context and completeness, our March 7 memorandum summarized all of the SEC’s principal requests for data. It noted, however, that not all of the questions in the Consultation directly relate to the sale of mutual funds and other registered investment companies. In fact, the Consultation is product-neutral—its questions relate to the provision of advice about any security to retail investors, and are not limited to advice about mutual funds and other registered investment companies. Accordingly, many of the requests for data may be outside the scope of any ICI response to the Consultation.

The remainder of this memorandum summarizes the requests for information that are most likely to be germane to the sale of registered funds.; For a more complete description of the

Consultation, please see our March 7 memorandum.

Request for Data Relating to the Current Market for Personalized Investment Advice

The Consultation begins with a request for data and other information about the specific costs and benefits associated with the current regulatory regimes for broker-dealers and investment advisers, and in particular the economics and characteristics of the current regulatory regime, conflicts of interest, and the cost and effectiveness of disclosure.

Nearly all of the fourteen separate requests for information in this part of the Consultation appear primarily directed at broker-dealers and investment advisers that deal directly with retail clients. The most germane question for ICI members may be Question 4, which asks “What are the types of securities broker-dealers or investment advisers offer or recommend to retail customers?”. Follow-up questions ask whether commenters believe that differences in the standards of conduct under the two regulatory regimes contribute to differences in the types of securities offered, and if so, whether there is data and other information as to why the types of securities offered or recommended may differ.

ICI’s response could provide data on the types of share classes primarily used by broker-dealers versus advisers. We are particularly interested in members’ response to the follow-up questions, and whether you believe that the standard of conduct contributes to the different types of share classes used in each channel.

Uniform Fiduciary Duty for Broker-Dealers and Investment Advisers

Assumptions

In order to provide a common baseline for comments, the SEC sets forth a number of initial clarifications and assumptions, many of which directly address concerns expressed previously by ICI and other commenters. These are described in detail in our March 7 memorandum.

Although the SEC expressly states that these clarifications and assumptions do not suggest their policy views or the ultimate direction of the SEC’s actions on these issues, ICI might choose to reiterate concerns with respect to some of these assumptions. In particular:

- **Principal trades.** ICI has encouraged the SEC, as it considers whether to allow broker-dealers to engage in principal trades consistent with a new fiduciary duty, also to revisit its interpretations under Section 206(3) for investment advisers. The Consultation does not ask for data or other information on this particular point. Rather, it asks commenters to assume that the uniform fiduciary standard of conduct would permit broker-dealers to continue to engage in principal trades, and the rule would not incorporate the transaction-by-transaction disclosure and consent requirements of Section 206(3) of the Advisers Act.; It also expressly states that the new rule would not relieve an investment adviser from its obligations under Section 206(3), which would continue to apply to investment advisers.
- **Proprietary products.** The Consultation asks commenters to assume that the offering or recommending of only proprietary or a limited range of products would not, in and of itself, be considered a violation of the uniform fiduciary standard of conduct. Do ICI

members affiliated with retail broker-dealers disagree with this assumption? If not, why not?

Discussion of the Contours of a Fiduciary Duty

In describing how the SEC might implement a new fiduciary standard of care, the Consultation discusses the two key components of a fiduciary duty—the duty of loyalty and the duty of care—and the application of prior guidance and precedent.

There are portions of this discussion that ICI may choose to comment upon, including:

- A new “relationship guide” for broker-dealers. The Consultation asks commenters to assume that any rule under consideration would expressly impose certain disclosure requirements, including disclosure of all material conflicts of interest the broker-dealer or investment adviser has with respect to that retail customer and the delivery of a “general relationship guide” similar to Form ADV Part 2A, to be delivered at the time of entry into a retail customer relationship.; ICI has supported the concept of a product-neutral conflicts disclosure document for brokers, and could reiterate that support in our comment letter. [\[3\]](#)
- Fair and reasonable compensation. Commenters are asked to assume that the new rule would include a requirement that broker-dealers and investment advisers receive compensation for services that is fair and reasonable, taking into consideration all relevant circumstances.

Request for Data and other Information on the Impact of a New Fiduciary Duty

As noted in our March 7 memorandum, the Consultation suggests six possible courses of action for the SEC, and requests data or other information on the changes in the marketplace for personalized investment advice for retail customers that might occur as a result of following each of the six courses of action. [\[4\]](#) The Consultation also lists a number of services and activities commenters had highlighted as most likely to be impacted by a fiduciary duty. Four of these are particularly germane to the sale of mutual funds and other registered investment companies:

- Recommending proprietary products and products of affiliates;
- Recommending a limited range of products and/or services;
- Advising on a trading strategy involving concentrated positions; and
- Receiving third-party compensation in connection with securities transactions or distributions (e.g., sales loads, ongoing asset-based fees, or revenue sharing).

We are interested in members’ views as to whether a new fiduciary standard for broker-dealers would impact these activities, and if so, whether members have any data or other information that might demonstrate that impact.

Discussion of Potential Areas for Further Regulatory Harmonization

The final section of the Consultation seeks comment on potential areas, other than the standard of conduct, where the SEC might consider harmonizing the regulatory obligations of broker-dealers and investment advisers. The SEC seeks data and other information on costs and benefits in this section, but also more broadly seeks comment on whether the SEC should pursue harmonization in these areas, and if so, how.

The areas for potential harmonization include:

- Advertising and other communications. The SEC requests data on the general idea of harmonizing regulatory requirements for advertisements and other communications, and more specifically on developing similar substantive content rules and/or guidance, establishing consistent pre-use review requirements, and establishing consistent pre- and post-use filing requirements for broker-dealers and investment advisers.
- The use of finders and solicitors. The SEC requests data on harmonizing the existing regulatory requirements applicable to finders and solicitors. In particular, the SEC seeks data on the impact of establishing conflicts disclosure requirements associated with a solicitor's or finder's receipt of compensation.
- Supervision. The SEC seeks feedback on harmonizing supervisory requirements of investment advisers and broker-dealers, including whether there are different costs and benefits to establishing a single set of universally applicable requirements versus scaling requirements based on the size (e.g., number of employees or a different metric) and nature of a broker-dealer or an investment adviser.
- Licensing and registration of the firms. In addition to seeking data on the idea of harmonizing the licensing and registration of broker-dealers and investment advisers generally, the SEC seeks input on harmonizing the disclosure requirements in Form ADV and Form BD to the extent they address similar issues and imposing a substantive review of investment advisers prior to registration.
- Continuing education requirements for associated persons. In addition to a general request for data, the SEC seeks data on the impact of requiring associated persons of investment advisers to be subject to federal qualification examinations and continuing education requirements.
- Books and records requirements. The SEC specifically requests data on the impact of applying the "business as such" record retention requirement of Securities Exchange Act of 1934 Rule 17a-4 to investment advisers.

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endnotes

[1] See Memorandum No. [27086](#), dated March 7, 2013.

[2] Duties of Brokers, Dealers, and Investment Advisers, SEC Release No. 34-69013 and IA-3558 (March 1, 2013), available at <http://www.sec.gov/rules/other/2013/34-69013.pdf>. For purposes of the Consultation, commenters are asked to assume that the term "personalized investment advice about securities" would include a "recommendation," as interpreted under existing broker-dealer regulation, and would include any other actions or communications that would be considered investment advice about securities under the Advisers Act (such as comparisons of securities or asset allocation strategies), but would not include "impersonal investment advice" or general investor educational tools, and the term "retail customer" would mean "a natural person, or the legal representative of such natural person, who (1) receives personalized investment advice about securities from a broker or dealer or investment adviser and (2) uses such advice primarily for personal, family, or household purposes."

[3] See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to

Marcia E. Asquith, Office of the Corporate Secretary, FINRA, dated Dec. 24, 2010, available at <http://www.ici.org/pdf/24814.pdf>.

[4] The six approaches are: (1) take a disclosure-only approach; (2) adopt a uniform standard without extending existing guidance and precedent; (3) adopt a new rule or standard only for broker-dealers; (4) adopt a new rule only for investment advisers; (5) consider models set by regulators in other countries; and (6) retain the status quo.

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