

MEMO# 30819

August 8, 2017

ICI Files Comment Letter with SEC in Response to SEC Chairman's Statement on Standards of Conduct

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TO: ICI Members
Investment Company Directors
Pension Committee
Pension Operations Advisory Committee
SEC Rules Committee
Small Funds Committee SUBJECTS: Compensation/Remuneration
Compliance
Disclosure
Distribution
Fees and Expenses
Intermediary Oversight
Investment Advisers
Operations
Pension RE: ICI Files Comment Letter with SEC in Response to SEC Chairman's Statement on Standards of Conduct

On August 7, ICI filed the attached comment letter with the Securities and Exchange Commission (SEC or “Commission”), responding to a public statement from Chairman Clayton requesting comment on standards of conduct for investment advisers and broker-dealers.[\[1\]](#) Our letter, which is summarized briefly below, recommends that the Commission adopt—and that the Department of Labor (DOL) recognize in a streamlined exemption—a best interest standard of conduct for broker-dealers that would apply when they make recommendations to retail investors in non-discretionary accounts, whether those investors are saving for retirement or other important goals. This best interest standard would achieve Chairman Clayton’s stated objectives of clarity, consistency, and coordination with DOL. Our letter also recommends that the SEC maintain the existing fiduciary duty standard for investment advisers that has served investors well for over seven decades.

We begin our letter with a discussion of how the DOL’s fiduciary rulemaking has harmed

investors and disrupted the financial advice market. The letter highlights the need for the SEC to act to ensure that retail investors' interests are put first, while preserving investors' access to the products and services necessary to meet their savings goals.

Our letter recommends that the SEC take the lead in establishing and enforcing a best interest standard for broker-dealers that would apply consistently across retirement and non-retirement accounts. This enhanced standard of conduct would better serve investors and would mitigate the harms that the fiduciary rulemaking is causing. Our letter notes that only the Commission can issue a standard of conduct that will apply to broker-dealers' conduct across both retirement and non-retirement accounts. The SEC also could enforce a best interest standard directly, unlike the DOL. As the primary regulator of broker-dealers, the SEC has enforcement authority over them both directly and through FINRA. An SEC-issued best interest standard therefore would avoid the risk, expense, and uncertainty that the DOL's "Best Interest Contract" or BIC exemption has created because of its reliance on a private right of action for enforcement.

Our letter also urges the SEC to coordinate closely with DOL so that DOL explicitly recognizes the best interest standard of conduct in a corollary streamlined prohibited transaction exemption for financial services providers that are subject to an SEC-governed standard of conduct. We emphasize the importance of SEC-DOL coordination given the upcoming January 1, 2018 full compliance date for the fiduciary rulemaking. We urge the SEC and DOL to synchronize efforts with respect to timing to prevent further investor harm and confusion, and avoid unnecessary implementation and compliance costs.

Description of Best Interest Standard of Conduct for Broker-Dealers

Our letter outlines the following recommended standard of conduct for broker-dealers. This standard would enhance the existing suitability requirements and other obligations that currently apply to broker-dealers under the Securities Exchange Act of 1934, the rules thereunder, and FINRA rules.

Best Interest Standard of Conduct. Our recommended best interest standard would require that a broker-dealer's "recommendation" to a retail customer in a non-discretionary account be in that customer's best interest at the time the recommendation is made, incorporating an explicit duty of loyalty and a duty of care, with the following affirmative obligations:

Duty of Loyalty

- **Client's Interest First.** The standard would require that a broker-dealer's recommendation to a retail customer not put the broker-dealer's interests (or the interests of anyone else) above the client's interests.

Duty of Care

- **Diligence, Care, Skill, and Prudence.** The standard would require a broker-dealer's recommendation to a retail customer to reflect (1) reasonable diligence; and (2) reasonable care, skill, and prudence based on the customer's investment profile.

Fair and Reasonable Compensation. A broker-dealer would be required to charge no more than reasonable compensation for services to its customer.

Disclosure. The best interest standard would require that the broker-dealer disclose to the customer certain key aspects of its relationship with the customer—such as the type and scope of services provided, the applicable standard of conduct, the types of compensation it or its associated persons receive, and any material conflict of interest.

No Misleading Statements. A broker-dealer would be prohibited from making any misleading statements about the transaction, compensation, or conflicts of interest.

Policies and Procedures. Broker-dealers would be subject to existing regulation requiring them to adopt policies and procedures reasonably designed to prevent violations of the applicable standard of conduct.^[2] FINRA already requires a broker's written procedures and supervisory system to be reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules. The recommended policies and procedures would fall within the scope of this FINRA requirement.

Application of Standard. The standard would be triggered whenever a broker-dealer makes a recommendation to any customer having a non-discretionary account. For this purpose, FINRA's definition of "recommendation" would apply.^[3]

Scope of Standard. A best interest standard of conduct for broker-dealers would permit the broker-dealer to limit the scope, nature, and anticipated duration of the relationship with the customer.

Definition of "Recommendation." In crafting a best interest conduct standard for broker-dealers, we urge the SEC to define "recommendation" consistently with FINRA's definition of "recommendation." FINRA's definition of "recommendation" and related guidance clearly identify conduct that would subject a broker-dealer to a best interest standard, and appropriately reflect the typically episodic nature of a broker-dealer's relationship with its customer.

A broker-dealer would be able to engage in the following activities or practices, consistent with our recommended best interest standard, if the broker-dealer provides appropriate disclosure and the product or service is in the customer's best interest:

- Selling an investment product and receiving compensation in the form of commissions or other traditional broker-dealer compensation for customer transactions.
- Selling proprietary investment products.
- Engaging in principal trading, subject to appropriate limitations, disclosure, and customer consent.

In addition, the letter explains that certain common activities not constituting the making of a recommendation should not cause broker-dealers to be subject to a best interest standard. For example:

- Offering the use of financial calculators or similar investment tools for general informational purposes.^[4]
- Providing information about investment products derived from third-party sources, such as prospectuses, fund fact sheets, and independent third-party ratings information.
- Executing unsolicited trades.

- Servicing orphaned accounts, including a limited purpose broker-dealer (*i.e.*, fund distributor) providing information about the shareholder's options. This would include holding an account directly with the fund and not re-establishing an intermediary relationship.

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[Attachment](#)

endnotes

[1] See ICI Memorandum No. 30725 (June 2, 2017), available at https://www.ici.org/my_ici/memorandum/memo30725.

[2] See FINRA Rule 3110.

[3] See FINRA Rule 2111.

[4] The letter recognizes that the use of these types of tools may, in some circumstances, entail a recommendation, in which case the broker would be subject to the best interest standard.