INSTITUTE FOR THE FIDUCIARY STANDARD

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Statement of Knut A. Rostad On "Best Interest" and SIFMA's "Proposed Best Interest of the Customer Standard For Broker-Dealers"

Introduction

The "Best Interest" standard is central to the regulation of advisers and brokers. It's key to the DOL COI proposed rule and recent SEC statements and decisions. Now, a Securities Industry Financial and Markets Association (SIFMA) statement discusses conflicts of interest, disclosure and fee transparency. The statement, a "Proposed Best Interests of the Customer Standard for Broker-Dealers" was released June 3. http://www.sifma.org/issues/item.aspx?id=8589954937

The statement highlights SIFMA's record commenting on a standard for broker -- dealers, which includes the foundation SIFMA statement on a uniform standard set out in 2011. http://www.sifma.org/issues/item.aspx?id=8589934675

SIFMA's views regarding conflicts of interest and fee transparency deserve particular note because they reveal implicitly and clearly SIFMA's view of regulation.

SIFMA on Conflicts

SIFMA focuses on disclosing and managing conflicts, while omitting mentioning why conflicts matter in regulations. There is no mention of why conflicts have been viewed as incompatible with objective advice in legal doctrine through history. There is no discussion – not even a mention – of the well-known harmful nature of material conflicts. Crucially, there is no mention of the ineffectiveness of disclosures and the consequent overriding mandate to *avoid* – and not *disclose* – conflicts.

SIFMA on Fee Transparency

A new and constructive part of SIFMA's statement is its mention of "investment-related" fees, which must be "reasonable, fair and consistent with the customer's best interest." This statement represents a new development for SIFMA. In SIFMA's foundation statement (noted above) on a uniform or best interest standard in 2011, there was no mention of "reasonable" fees and expenses. Further, some SIFMA language is

very similar to language in papers of the Institute which discuss the importance of investment expenses (see cited examples below).

Conclusion

A strong "Best Interest" standard is vital to protect investors and inspire trust in the markets. The DOL proposed rule suggests the "Best Interest" standard should be set high, based on ERISA rulings and trust law.

The SEC views "Best Interest" differently. An April 2015 Institute paper discusses the duty of loyalty and the "Best Interest" standard at the SEC. Its key conclusion: the SEC believes advisors need not avoid or manage conflicts; disclosing material conflicts, alone, serves clients' best interests. http://www.thefiduciaryinstitute.org/wpcontent/uploads/2015/04/ SECandConflictsApriil62015-copy.pdf

In this context, while SIFMA's new discussion of fees is noteworthy and positive, it is overshadowed by SIFMA's entirely incomplete discussion of conflicts. Incomplete because SIFMA offers no explanation why conflicts matter, or how material conflicts *harm* investors or how disclosures *fail* investors, or the burden that conflicts put on advisors, as set out in the SEC case, *In the Matter of Arlene Hughes*.

This silence on conflicts' includes the pivotal role conflicts played during the birth of modern federal regulation of investment advisers – the Advisers Act of 1940. Conflicts played a central role in the discussions, a role the Supreme Court affirms in detail in 1963 in SEC v. Capital Gains. Here the Court discussed the record, which it said, essentially, stressed that investment advice should be "as free as humanly possible (from) … prejudice." The authors of the Advisers Act aimed for a high standard, a legal basis for "competent, unbiased, and continuous advice." A standard aimed to ensure, "all conflicts of interest between the investment counsel were removed."

SIFMA's statement on best interest, six years after the financial crisis, is important and invites comparisons with the discussions in 1940, 11 years after the market crash. SIFMA's focus on disclosing conflicts and not removing conflicts speaks loudly of the group's view of fiduciary duty and the meaning of serving investors best interests. Its view contrasts sharply with the broad, robust and high standard envisioned and set out by the authors of the Advisers Act. Its view "conflicts" squarely and completely with the view eloquently and emphatically affirmed by the Supreme Court in 1963.

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SIFMA: Proposed Best Interest of the Customer for Broker Dealers
June 3, 2015

…. ii. Manage investment-related fees. A member shall ***ensure that investment-related fees incurred by the customer from the member are reasonable, fair,*** and ***consistent with the customer's best interests***. Managing investment-related fees ***does not require recommending the least expensive alternative***, nor should it ***interfere with making recommendations from among an array of services, securities and other investment products*** consistent with the customer's investment profile.

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11. Consider peer group rankings in ***ensuring compensation and expenses are reasonable***.

Controlling investment expense ***should not interfere with the fiduciary being able to recommend from a broad array of securities and other investment vehicles*** consistent with the client's risk tolerance, time horizon and sophistication. Similarly, broad discretion does not free the fiduciary from the duty to avoid unnecessary expenses and the duty to justify investment costs, particularly if they exceed peer group averages or typical expenses for the risk assumed. Similar to the working definition of "best execution," controlling investment expenses ***does not require the least expensive alternative***; it does require a reasonable basis and full explanation for higher than "average" expenses……

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"Regardless of (client) consent ***the fiduciary advisor must show the transaction is fair and reasonable and consistent with the client's best interest."***

- Revised June 22, 2015