INSTITUTE FOR
THE FIDUCIARY STANDARD

August 6, 2018

The Honorable Jay Clayton
Chairman
United States Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Regulation Best Interest; File No. S7-07-18

Dear Chairman Clayton:

I write, as president of the Institute for the Fiduciary Standard*, in response to your request for comment on standards of conduct for investment advisers and broker dealers. This letter addresses Regulation Best Interest (RBI).

Introduction

The SEC has a unique and vital role in overseeing over 12,000 registered investment advisers with trillions of dollars in assets held by 54% of U.S. households, according to Gallup. Fiduciary duties serve to guide adviser conduct; the Commission edits and publishes the guide. Your guidance is critical for advisers seeking to know they meet the standard and, also, to 'self-police' their own actions.

The SEC has released three proposed rules on conduct standards for brokers-dealers and investment advisers. The rules, entailing 1,000 pages, are found on the SEC website.[1] This letter reviews recent developments at the SEC, core features of the proposed RBI COI and key elements of what a real best interest standard regarding conflicts of interest obligations should entail. It also offers proposed hypothetical disclosure for advisers and brokers.

[1] https://www.sec.gov/rules/proposed.shtml

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Executive Summary

Conflicts of Interest, Ethics, Disclosure and
Broker / Adviser Differences in Regulation

The cornerstone of Regulation Best Interest (RBI) is the Conflict of Interest Obligations (COI). This is where RBI meets the policies and procedures of a compliance and ethics program. What happens here determines if RBI succeeds in establishing and enforcing a best interest standard. It does not. Sadly, over recent years the SEC has made ethics and conflicts less important, disclosure more important and brokers and advisers have been treated alike.

<u>Modern securities regulation then and now</u>

Modern securities regulations and laws were conceived, literally, from *ethics*. In April 1933, President Roosevelt spoke with Richard Whitney, NYSE president, about a code of ethics, 'simple enough for the public to understand.' The framers of the Advisers Act of 1940, expressed a concern of a lack of integrity in securities. The Supreme Court affirmed their concern and a federal fiduciary duty for advisers in the Advisers Act in 1963. Throughout, conflicts were deemed inherently pernicious to competent advice. Securities regulation and ethics were joined to combat them.

Since 1963, much has changed, of course. In the early 1980s, BDs started promoting advice and financial planning. Traditional distinctions between brokers and advisers blurred. Rand reported investors saw these blurred lines in 2008. SEC Chair Schapiro noted a "merging" of brokers and advisers in 2009. Then, from 2013-2015, SEC staff talked more about adviser and broker similarities and administrative decisions put disclosing conflicts clearly ahead of assessing a best interest standard. As Bob Plaze explained in 2015, "Where would that take me if I were to decide" what is best interest.

Analysis of RBI: Conflict of Interest Obligations

<u>RBI fails investors. It fails to provide a real best interest standard and fails to require or urge that brokers eliminate conflicts or even mitigate them in any concrete and specific way</u>

RBI was anticipated with widespread hope. Consumer Federation called for, a "principle-based legally enforceable best interest standard" for brokers. However, RBI has disappointed most parties. It fails to provide investors a best interest standard. First RBI fails to set out the premises and priorities of a principles-based fiduciary standard for retail investors. There are no core tenets of the fiduciary duties of loyalty and care that meet the reasonable expectations of Main Street investors. Second, RBI fails to address conflicts. It permits broker-dealers wide latitude to establish "policies and procedures to address financial incentives, latitude evident in explicit statements and implicit premises.

- RBI worries that if brokers eliminate conflicted recommendations they will lose revenue and their customers will be harmed by not buying these products (RBI, 274).
- RBI ignores core differences between advisers and brokers. It ignores basic legal, contractual and business differences, relationships of two versus three.

- RBI policies and procedures provide no requirements nor offer uniform guidance, and do not define "mitigation" or "best interest." BDs have the flexibility to do largely what they like.
- RBI has literally removed the word "ethics" from its conduct standard language. In the 125,993 word RBI document, we find the word is mentioned three times, and not regarding the RBI proposal.

BDs' poetic license in writing policies and procedures to meet an undefined RBI BI standard? A BD that already believes it meets the FINRA BI standard will certainly do what it knows. This may be why Commissioner Stein suggests in her statement that RBI is better called, "Regulation Status Quo."

RBI represents a major step towards codifying in SEC Rulemaking principles and practices that further deemphasize conflicts of interest and codes of ethics and differences between brokers and advisers, while advancing disclosure as the bulwark of investor protection.

A best interest standard is founded on
principles of the fiduciary duties of loyalty and care

The Institute offers two central recommendations to reconstruct RBI. The first is to adopt fiduciary principles that require rigorous practices appropriate for retail investors in 2018. Rigorous practices must reflect retail investors' recognized short comings and the debilitating impacts of material conflict's harms. The DOL Rule description of best interest is an excellent model. In part, it states:

> "Investment advice is in the ''Best Interest'' of the investor when the Adviser and Financial Institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity….without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party."

The second recommendation is to require appropriate policies and procedures to enforce the principles. Eliminating or disclosing and mitigating conflicts are not practices with which brokers generally have training and experience. Policies and procedures should be designed to offer BDs concrete assistance, and reflect the well-known fact that mitigating material conflicts is challenging.

Casual disclosure alone fails to mitigate the debilitating harms of material conflicts. The criteria required to fulfill the stiff requirements of the Advisers Act of 1940 are far more than mere that casual disclosure and consent that is inferred. The criteria are:

1. <u>Disclosures must be affirmative</u>. The adviser or broker must proactively deliver disclosures.

2. <u>Disclosures must include "specific facts".</u> The SEC emphasizes that conflicts must be disclosed "with sufficiently specific facts so that the client is able to understand (them) … and can give informed consent to such conflicts or practices or reject them."

3. <u>Disclosures must be understood.</u> This means that while specific facts are necessary, alone they may be insufficient. The nature of how the disclosure is written and delivered also matters. Disclosure must "Lay bare the truth … in all its stark significance", as Justice Cardoza wrote.

Further, the SEC has noted, "In the Matter of: Arlene W. Hughes", there is no one appropriate disclosure method, no 'one size fits all' because "The method and extent of disclosure depends on the particular client involved." Former SEC Chief Counsel, Louis Loss, underscored that the fiduciary obligation cannot be delegated to a client through a disclosure, as he said, "In all cases, however, the burden is on the firm which acts as fiduciary, to make certain that the client understands."

4. <u>Informed consent must be attained.</u> Written client consent must be "clear and specific to the transaction" and intelligent, independent and informed."

5. <u>The transaction must be fair and reasonable.</u> Even with client consent, "the proposed recommendation must be fair and reasonable, because as professor Tamar Frankel writes, "Courts will generally not enforce an unfair and unreasonable bargain."

Proposal RBI is transformational

Proposal RBI is transformational. Its implications are clear. It rejects the core premises of the Advisers Act of 1940 and fiduciary principles dating from Hammurabi. It, literally, removes ethics from the conduct standards language. It openly expresses concern for brokers losing revenue from eliminating conflicts. It ignores mountains of research validating retail investors' shortcomings, and the failures of disclosure as an investor protection tool. It ignores research, from conservative and liberal think tanks alike, testifying to the crisis that places the trustworthiness of financial professionals alongside Congress and car salesmen. It ignores research that shouts out the remedy: straight forward transparency and clarity around conflicts and fees. Its own language unambiguously describes, as Commissioner Peirce notes, a "suitability plus" standard.

Despite this plain "clarity", the release and the subsequent explanations from SEC officials offer a mythical picture of RBI that obliterates basic sensibilities. Take the repeated claims that brokers will be obliged to disclose and to also mitigate certain conflicts. This a key issue. The acknowledged failures of "disclosure alone" actually unites most stakeholders. Unfortunately though, a journey through the explanations of what RBI currently requires reveals "mitigation" means "disclosure."

Or, take the issue of "fee disclosure." RBI speaks of disclosure of "certain categories of fees they should expect to pay" to mean the methods and sources of compensation. The "how" of compensation. RBI explicitly rejects requiring that a broker actually be required to disclose the fees a retail customer pays, saying, "We are not proposing a requirement that firms personalize the fee disclosure for their retail customers." The difference is important because investors differentiate between *how* a vendor is compensated and paid by a customer, ('We take checks and credit cards') and *what* a professional is paid ('These services cost you $3750.) Despite this clear and important difference, RBI has been explained by SEC staff to mean 'brokers are required to disclose all fees.' To conflate these disclosures may have the unintended effect of misleading investors. This confusion should be cleared up.

The Institute cannot support RBI as proposed. It requires a major reengineering, as noted above, to meet the requirements of a real fiduciary standard. We welcome the opportunity to assist the SEC in doing so.

**Background: A review of the SEC journey on conduct standards;
from a mandate to avoid conflicts, to a call to embrace conflicts**

The assumptions embedded in the proposals are not new at the SEC. They culminate a decade of statements from top SEC officials and former officials pointing out that BD and IA conduct is largely similar, and that investors do not understand their differences.

The landmark study by Rand in 2008 provides the framework for viewing how brokerage sales and fiduciary advice is treated. Most notably, Rand states, "… Investors typically fail to distinguish broker-dealers and investment advisers along the lines defined by federal regulations," … and this increasingly blurred line is due to recent marketing by broker-dealers on the ongoing relationship between the broker and the investor.[2]

On June 17, 2009 the Obama Administration Treasury paper[3] on financial regulation reform was issued. On June 18, SEC Chairman Mary Schapiro spoke on fiduciary duty in New York.[4]

In these remarks, the Chairman builds the case for a "uniform" or "harmonized" standard by maximizing the similarities and minimizing their significant, structural and contractual differences. She does not mention, for example, that broker dealers exist to distribute products and are paid by issuers and manufacturers, and investment advisers exist to render fiduciary advice under law and are paid by clients to do so.

Specifically, Chairman Schapiro reached out to express the principle that a "divide" does not separate broker-dealers from investment advisers. She said that brokers and advisers were "merging" together. The Chairman, interestingly, actually "merged" marketing labels with legal duties in categorizing the term broker dealer with the term, "financial consultant."

> *"…It is hardly a divide. In fact rather than growing further apart, the two industries are merging to the point of, in some cases, relative indistinguishability." The chairman adds, from the retail investor perspective, "When a retail investor turns to a financial professional for investment advice or assistance … there are broker-dealers, investment advisers, FAs, financial consultants, and financial planners to name a few."*

Since 2011, the Institute has regularly written and spoken on this dominant view at the SEC of conduct standards. Key aspects of Section 913 of Dodd Frank in 2010, followed by the July 2011 SIFMA letter to the SEC and March 2013 SEC request for comments on a potential rule-making all buttress the idea in key respects of the "indistinguishable" conduct of brokers and advisers, and again contrary to established views, that broker-dealer rules often better serve investors receiving advice than do Act 1940 principles.[5]

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[2] https://www.sec.gov/news/press/2008/2008-1.htm
[3] https://www.treasury.gov/initiatives/wsr/Documents/FinalReport_web.pdf
[4] https://www.sec.gov/news/speech/2009/spch061809mls-2.htm
[5] Three Institute papers from 2013-2016 addressed these issues: A March 1, 2013 release by the SEC is discussed in an April 2013 Institute paper as it pertains to the assumptions regarding fiduciary duties embedded in the release (cont. on next page's footnotes) http://www.thefiduciaryinstitute.org/wp-content/uploads/2013/04/Fiduciary-Reference-April-16-2013.pdf; This paper, "Conflicts of Interest and the Duty of loyalty at the Securities and Exchange Commission", highlights recent SEC statements and rulings in 2015.

Early years

Conflicts of interests and ethical issues have driven federal securities regulation since 1933. Soon after his inauguration, President Franklin D. Roosevelt discussed with Richard Whitney, the President of the New York Stock Exchange, having the NYSE adopt a simple code of ethics.

FDR sought to extend fiduciary doctrine to the buying and selling of securities and creating a code of ethics for the securities industry that would be simple enough for the public to understand.[6] The framers of the Investment Advisers Act of 1940 expressed concerns with the lack of honesty and integrity in the securities industry building up to the market crash. Their main objective was to separate investment counselors (advisers) from "tipsters and touts" (sales brokers) to protect both investors and "legitimate advisers.[7]

The SEC's Arlene W. Hughes case in 1948 set out how much stricter is the agency or fiduciary standard than is the broker-dealer standard in addressing conflicts of interest in a principal transaction. Note example here.[8] The Supreme Court in 1963 affirmed a federal fiduciary duty in the Investment Advisers Act of 1940.[9]

The clear line separating brokerage sales and fiduciary advice remained until the early 1980s when broker dealers began rebranding brokers as advisers. In the early 1980s, brokerage firms explicitly promoted brokers' advice and financial planning services. As professor Arthur Laby notes, "One firm referred to the "quality of investment advice" it provided. "Total Financial Planning," another firm advertised, "requires a careful assessment of your entire financial situation, and the assembling of a financial profile that forms the basis of an approach to meet all your financial objectives."[10] Laby then points out that in the 1990s brokers started charging asset-based fees.[11]

It's the context of thirty-five years of this messaging that assessing "investor confusion" needs to be considered. Messaging that unambiguously communicates trusted advice services have been clear. Even though brokers who are recruited, obliged, trained and compensated to distribute products and represent manufacturers, they are advertised as advisers who are recruited, obliged, trained and compensated to render trusted advice. This is a material factor that should be central to understanding "investor confusion," over what brokers and advisers do. For a simple reason that Laby points out, *advertising works*:

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http://www.thefiduciaryinstitute.org/wpcontent/uploads/2015/08/SECandConflictsApriil62015.pdf; In the 2016 Institute working paper "What is 'Good Advice?'" the sharp differences in the views of those who believe that conflicts are okay, and those who emphatically do not, are discussed in greater detail. http://www.thefiduciaryinstitute.org/wp-content/uploads/2016/05/WhatisGoodAdvice.pdf

[6] https://scholarlycommons.law.hofstra.edu/cgi/viewcontent.cgi?article=2135&context=hlr

[7] Laby B., Arthur, Selling Advice and Creating Expectations: Why Brokers Should Be Fiduciaries, http://www.thefiduciaryinstitute.org/wp-content/uploads/2013/02/LabySellingAdviceCreatingExpectations.pdf at 718.

[8] Huges v. Securities and Exchange Commission 174 F.2d 969 (1949), http://www.brightlinesolutions.com/files/Plaze/EnfHughes.pdf

[9] Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., et al., 375 U.S. 180 (1963), https://www.sec.gov/divisions/investment/capitalgains1963.pdf

[10] Laby, at 755

[11] Ibid, at 728.

> *Advertising works. According to research in the field of emotional advertising, one can develop positive beliefs about a subject's attributes merely by having a positive emotional reaction to an advertisement. Emotions such as "warmth" can relax the viewer and put him in a positive state of mind. Warmth can be stimulated by pictures or by narratives of friendship, caring, and tenderness. These feelings may be engendered through brokerage advertisements discussed above, particularly those suggesting that brokerage employees will provide trust, guidance, advice, answers, and help.*[12]

<u>2008: SEC views right after the financial crisis</u>

Fast forward to the first years since the 2008 financial crisis. The SEC's general view was to continue to urge conflict avoidance. While there is no question advisors may choose to either eliminate or to disclose conflicts, the SEC had urged that advisors avoid conflicts. The SEC staff advocated avoidance; i.e., for advisors: "As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and, at a minimum, make full disclosure of all material conflicts…"[13]; or "You should not engage in any activity in conflict with the interest of any conflict…You must eliminate or at least disclose, all conflicts of interest…"[14]

A veteran SEC staff member (whose view does not necessarily reflect SEC views) expressed this view even more succinctly: "An adviser must act solely for the benefit of its client and must not place itself in a position of conflict with its client. *An exception is made* (emphasis added), however, when the adviser makes full disclosure to its client and obtains the client's informed consent."[15]

In 2012, Carlo V. di Florio, then Director, SEC Office of Compliance Inspections and Examinations, spoke bluntly about why conflicts of interest are so important to the SEC.[16]

> *"Conflicts of interest can be thought of as the viruses that threaten the organization's well-being. …These viruses come in a vast array of constantly mutating formats, and if not eliminated or neutralized, even the simplest virus is a mortal threat to the body."*

These views reflect the views, generally, expressed of conflicts in the Capital Gains decision that recognized a fiduciary duty in the Investment Advisers Act. Here, the Supreme Court opinion, "... investment advisers could not 'completely perform their basic function – furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments -- unless all conflicts of interest between the investment counsel and the client were removed.'"[17]

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[12] Ibid, at 765.
[13] Form ADV, Part 2. General Instructions, https://www.sec.gov/about/forms/formadv-part2.pdf, at 1.
[14] Information for Newly-Registered Investment Advisers, "Investment Advisers are Fiduciaries." https://www.sec.gov/divisions/investment/advoverview.htm
[15] The Regulation of Investment Advisers, Robert E. Plaze, Updated to November 22. 2006. https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042006.pdf
[16] http://www.sec.gov/News/Speech/Detail/Speech/1365171491600#.VRBoKI4sq6U
[17] Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., et al., 375 U.S. 180 (1963), https://www.sec.gov/divisions/investment/capitalgains1963.pdf at 5.

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Recent years, 2013 to 2018: A different tone

Views about conflicts of interest at the SEC appear to start to change around 2013. Since then, clearly negative views about conflicts of interest have been less dominant. Instead, more nuanced and ambiguous – or even positive – views of conflicts have become more dominant. The foundation of these views was bolstered by key aspects of Section 913 of Dodd Frank in 2010, by effectively approving of the conflicts in proprietary products and situations of limited product choices.[18] The July 2011 SIFMA letter to the SEC further set out a road map for the SEC to accommodate BD products and practices.[19]

From 2013 to 2015, for example, we find:[20]

- The March 2013 SEC Request for Information on a potential uniform rule for advisers and brokers uses assumptions that weaken and narrow fiduciary duties, whiling urging conflicts.
- Three SEC administrative decisions in 2014 and 2015 dealing with disclosures and conflicts frame the cases as disclosure failure cases. There is no finding in the cases of the adviser failing to act in the best interest of the client.
- Former Chief Counsel of the Division of Trading and Markets, David Blass, in Compliance Intelligence, in April 23, 2014, stated: "I don't think that the adviser fiduciary duty is higher than suitability."
- Two former SEC regulators, Troy Paredes, former Commissioner, and Robert Plaze, at the September 2014 'Fiduciary Summit' organized by TD Ameritrade, agreed that only "2—3%" of enforcement cases turn on the difference between the suitability and fiduciary standards.
- A February 2015 speech by Julie M. Riewe, Co-Chief, Asset Management Unit (AMU) SEC Division of Enforcement, concludes that disclosure alone presumptively cures conflicts.
- Former SEC Associate Director of Investment Management, Robert Plaze, in comments on the Riewe remarks, generally, reaffirms the principle that the SEC does not today independently assess the 'best interest' of clients' in evaluating enforcement decisions regarding conflicts.
- SEC Chair White, in her remarks March 2015, expressed concerns about brokers deserting the market because of fiduciary requirements when she noted, *"if what we succeed in doing is, in effect, depriving investors of … reliable, reasonably priced advice, obviously we have failed."*

[18] https://www.congress.gov/bill/111th-congress/house-bill/4173/text
[19] https://www.sifma.org/wp-content/uploads/2017/05/sifma-submits-comments-to-the-sec-on-a-proposed-framework-for-rulemaking-under-section-913-fiduciary-duty-of-the-dodd-frank-act.pdf
[20] Examples sourced from http://www.thefiduciaryinstitute.org/wp-content/uploads/2015/08/SECandConflictsApriil62015.pdf

Conflicts, Conflicts, Everywhere

Julie M. Riewe, Co-Chief, Asset Management Unit (AMU) SEC, Division of Enforcement, spoke at an industry conference, "Conflicts, Conflicts, Everywhere ..." in February 2015. In these remarks, Riewe discusses, among other things, conflicts.[21]

> *"To fulfill their obligations as fiduciaries, and to avoid enforcement action, advisers must identify, and then address - through elimination or disclosure - those conflicts.... Only through complete and timely disclosure can advisers, as fiduciaries, discharge their obligation to put their clients' and investors' interests ahead of their own."*

The meaning of this plainly written analysis is clear: disclosure, in and of itself, puts the interests of clients first, ahead of the interests of advisers. That is, irrespective of the risk, the costs, or the quality of the underlying investment, or the benefits of the investment recommendation to the firm or the adviser, the mere act of disclosing the conflict to the client puts the client's interests first.

Under this rationale, disclosure equates to serving the client's best interests. Moreover, it's the ONLY way. Riewe asserts that *only* though "complete and timely disclosure" can the duty to put their clients' interest first be discharged. On the role of disclosure in addressing conflicts of interest, former SEC Deputy Director of Investment Management Bob Plaze spoke about Riewe's speech:[22]

> *The issue with "best interest" is who gets to decide what is in the best interest of the client? Under the Advisers Act we presume that a client who has consented has determined that the arrangement or conflict (together with any remediation offered) is in his best interest or he wouldn't have consented. The client who instructs the adviser to use his brother-in-law has perhaps decided that it is in his best interest to do that. Who gets to overrule that judgment? I would never pay 2 and 20 for investment advice because I don't believe it is in my interest to do so, but who am I to quibble with the guy who believes it is in his best interest. There are plenty of people out there who believe that active management is foolish and not in the best interest of the client? I might agree with them, but where would that take me if I were anointed to decide the question.*
>
> *So that consent will be inferred, the disclosure has to be sufficiently robust to give a client the tools to understand what is in his best interest. That's why Part 2 of Form ADV now requires disclosure about the implications of disclosed conflicts. I wouldn't want to create a regulatory structure where clients are disabled from intelligently agreeing to arrangements or conflicts that I personally would refuse to consent. I would, for example, never agree to pay for advice from an adviser who was receiving sales compensation. But I wouldn't want to preclude other persons from entering into those arrangements with an adviser.*
>
> *A lot of trust law has developed in situations where the beneficiaries of the trust are for one reason or another incapable of giving consent. In those cases a court will*

[21] https://www.sec.gov/news/speech/conflicts-everywhere-full-360-view.html
[22]

> *substitute its judgment as to whether the trustee acted in the best interest of the client. The Advisers Act involves clients who are in most cases fully capable of providing consent. Failure to recognize that would send the SEC down a road of substituting its (or its staff's) judgments about best interest for the client's.*
>
> *.... In my view, as a general matter, the law assumes and should infer consent from disclosure.*

Here, Plaze argues that the SEC does not have a role in assessing best interest with conflicted advice.

1. The SEC cannot judge if a recommendation is in the best interest of the client. The client must. "Under the Advisers Act we presume that a client who has consented has determined that the arrangement or conflict (together with any remediation) is in his best interest or he wouldn't have consented" After all, "Where would that take me if I were anointed to decide."
2. Disclosure, inferred client consent will "always satisfy the adviser's duty of loyalty… disclosure has to be sufficiently robust to give the client the tools to understand what is in his best interest..."
3. Clients, by in large, are presumed to be able to do so. As Plaze says, "The Advisers Act involves clients who are in most cases fully capable of providing consent."

The Plaze argument that the SEC cannot judge whether a recommendation is in the best interest of the client has clear implications for how RBI is evaluated.

A Review of Regulation Best Interest (RBI): Conflict of Interest Obligations

<u>RBI as a Compliance Tool</u>

The Conflict of Interest (COI) obligations focus on policies and procedures "reasonably designed" to disclose (and mitigate for financial incentives) or eliminate material conflicts of interest (9). This focus means assessing RBI is largely a matter of reviewing it through the lens of a compliance function.

The lens of compliance, the SEC staff says starts with a culture of compliance. A strong firm culture is evident when policies are read broadly, not narrowly. The question is not, what rule an action may break. The question is, "Is this action fair to our clients and properly reflect our fiduciary obligation to put their interests before our own?"[23]

A strong culture stresses 'ethical duties to clients' and how senior executives 'own' the compliance duties. The 'tone from the top' is crucial. Does the CEO make it a clear firm priority in actions and budgets? Are the policies and procedures understood? Are compliance goals in the firm mission and values? Such as 'strong ethical standards' and 'integrity' and dealing with clients fairly and honestly.

[23] Modern Compliance, Vol. II, Print version, at 65.

Withering Ethics?

The cornerstone of RBI is the Conflict of Interest Obligations (COI). This is where RBI meets the policies and procedures of a compliance and ethics program. The word "ethical" appears 3 times in RBI's 408 pages, 125,993-word proposal. Each time it regards FINRA rules regarding sales practice; there is no direct reference with RBI.[24] In contrast, in a 5,276-word 2012 speech on compliance and conflicts by former SEC OCIE Director, Carlos V. di Florio, the word ethics or ethical were mentioned 27 times.[25] This is over 200 times more frequently per word than in di Florio's speech.

Key implicit assumptions that are embedded in RBI, but not stated and not explained

There are key assumptions embedded in the proposals that are neither clearly stated nor explained. Four are noted here.

First, core IA and BD differences are not deemed to be important. Core contractual and legal differences of BDs and IAs are not stated and explained. That broker dealers are in three-way relationships and represent issuers and underwriters and are generally only paid commissions for making sales – this is not said. That investment advisers are in two-way relationships and exist to represent clients and render fiduciary advice and are paid by clients to do so – is also not said. These differences are fundamental.

The recent Fifth Circuit Court decision to vacate the DOL Rule also reflects these differences. The Court differentiates advice in an "intimate relationship" and a position of "trust and confidence" of advisers from brokers who render advice "merely as an incident to their broker-dealer activities." Instead of highlighting, underscoring and explaining these differences, the proposals gloss over them.[26]

Second, conflicts are not depicted as inherently harmful requiring avoidance; rather, they're depicted as ubiquitous, often unavoidable, and/or quite acceptable and even desirable. While RBI acknowledges that eliminating a material conflict may benefit a retail customer (269), this benefit seems outweighed by the costs to brokers and their customers. RBI explains how eliminating conflicts costs brokers and harms investors:

> *Eliminating material conflicts…may impose potential costs on broker-dealers to the extent they determine [to no longer offer] certain recommendations or services, and therefore forgo some of the [associated] revenue stream. [This, in turn] may alter the incentives of registered reps to expend effort in providing quality service, and, therefore, may impose a cost on retail customers due to the potential decline in the quality of the recommendations. The same requirement may limit retail customer choice, and therefore impose costs on retail customers, because broker-dealers for compliance or other reasons, may determine to avoid recommending certain products to retail brokerage customers, despite the fact these products may be beneficial to*

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[24] "Ethical" appears only twice in footnote 10 on page 13 and once in-text on page 247. In each of these three cases, the context surrounding the use of "ethical" is describing "sales practices" in the suitability obligation of "fair dealing" pursuant to FINRA's Rules.
[25] https://www.sec.gov/news/speech/2012-spch103112cvdhtm#.VRBoKI4sq6U
[26] https://www.ca5.uscourts.gov/opinions/pub/17/17-10238-CV0.pdf at 22 and 23.

> *certain retail customers in certain circumstances. The Commissions acknowledges that, taken together, the proposed rules may generate tension between broker-dealers' regulatory requirements and their incentives to provide high quality recommendations to retail customers*. (274)

This discussion illuminates RBI's view of conflicts and retail customers. The concern for lost broker revenue from a customer not choosing a conflicted product and the reduced sales incentive to provide "high quality recommendation"[27] is curious. Would someone be faulted to wonder if these concerns were from a sales manager? The idea that conflicts inherently cause harm seems a foreign idea.

Thus, the inherent and material harmful nature of conflicts is not clearly stated and explained. The importance of avoiding conflicts is not discussed. The historical, legal and commonsense linkage between avoiding conflicts and the fiduciary duty of loyalty is not discussed. The overwhelming evidence in the academic research demonstrating the inadequacies and failures of disclosing conflicts is also not stated and discussed. The difficulty to effectively manage or mitigate conflicts is also not discussed. Absent these discussions, there is no urgency for brokers and advisers to eliminate as many conflicts as possible to serve a client's best interest.

<u>Third, conflicts are generally considered the same</u>. Conflicts are treated (with the exception of principal trading) as generally alike. That they differ, often significantly, as to their frequency, complexity, transparency and potential harm is also not stated and explained. For example, the commission grids and incentives under which most brokers operate are ever-present, complex and opaque. Their impact can be great. In contrast, IAs' conflicts are often less complex and more transparent and episodic. IARs who hold insurance licenses or who advise a client on whether to pay off a mortgage can be conflicted. Yet, these conflicts are straight forward and transparent and more understandable to clients.

<u>Fourth, fee and expense accounting is good, but it is not good enough to require disclosing</u>. Disclosure regarding when and how fees are assessed is discussed. This is good. A personalized fee and expense accounting of all in costs is also discussed. This is also good. The SEC, however, rejects requiring such fee accounting. Even though some advisers already provide such reports, the SEC says, it would be too burdensome and costly to require advisers or brokers do so. This is unfortunate. Research suggests this personalized fee and expense reporting is greatly sought by retail investors. Such reporting would ameliorate investor confusion and build trust. This is not stated and explained.

[27] More than revealing, the focus is misguided. The claim that BDs will lose an unacceptable amount of revenue, which will in turn cause the number of product offerings to decrease and quality of investment advice to decrease, is unfounded. Unfounded because, in preparation for the DOL Rule, many BDs made meaningful strides in preserving their revenue models while innovating new, investor-friendly product offerings and trimming underperforming funds (See examples in http://www.thefiduciaryinstitute.org/wp-content/uploads/2018/06/Financial-Firms-Make-Steps-Toward-Fiduciary-Is-This-Enough.pdf). Thus, there is compelling evidence to cast significant doubt on the validity of any claims that broker-dealers will lose revenue under greater regulation, and on the validity of the claim that investors will be harmed by such regulation.

What RBI Says Best Interest Means

RBI is introduced with notes of widespread support among industry participants and investor advocate groups for establishing "a fiduciary or best interest standard specific to broker-dealers" or a uniform standard for both brokers and advisers.[28] The proposal also points out "we considered" the "variety of products and services including the types of advice," BDs provide, investors characteristics, the "associated costs and relative affordability of such services, the embedded compensation conflicts associated with these products and services; and the potential impact of such conflicts…"
Further, there was consideration of retail investor confusion "about the obligations broker-dealers owe" when brokers make recommendations. These considerations were over-laid, it seems by concerns regarding the viability of certain products paid by commissions in a best interest environment. "We also sought to preserve – to the extent possible – investor choice and access to existing products, services, service providers, and payment options. … (as) we are sensitive to the potential risk that any additional burdens" may cause investors to lose choice and access" (37).

RBI is proposed as a conduct standard for brokers to "Act in the best interest of the retail customer" at the time a recommendation is made "without placing the financial or other interest of the broker-dealer…ahead of the interest of the retail customer." The release explains the proposed standard "builds upon, and is tailored to, existing broker-dealer relationships and regulatory obligations" (40).

The proposal essentially requires the broker fulfill three tasks. He must 1) disclose prior to the recommendation the material facts relating to the scope and terms of the relationship and "all material conflicts associated with the recommendation", 2) exercise reasonable care, skill and prudence, to have a "reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers,"(and) a particular retail customer, and 3) maintain written policies and procedures to "at a minimum disclose (and mitigate for financial product incentives), or eliminate all material conflicts of interest. (44 and 45). According to the proposal, among other results, these duties, as expressed, will enhance conflict disclosure, investor understanding and conflict mitigation.

The RBI release provides substantial explanatory background to provide clear indications as to how it may be interpreted. Among other issues, the proposal reveals:

- **Investors now come second.** Eliminating the language, *"without regard to the financial or other interests" and adding "without placing the financial or other interests of the broker-dealer…ahead of the interests of the retail customer."* The explanation for this change is to address a concern that prior language may be construed to mean that a BD must *"eliminate all conflicts."* Then, it is explained, *"Like other investment firms"* BD s have conflicts *"when recommending transaction (and) certain conflicts of interest are inherent in any principal-agent relationships" (48).*

[28] In RBI footnote 72, Consumer Federation is cited calling for, "a new standard for brokers" under the 34 Act and the fiduciary duty "must include a principle-based legally enforceable best interest standard;" the Investment Adviser Association is noted supporting "a best interest standard that is as robust as the fiduciary standard under the Advisers Act;" and Americans for Financial Reform, "A strong fiduciary best interest standard to all those who hold themselves as advisers or offer personalized investment advice to clients …" In footnote 73, PIABA notes that, "The lack of a uniform standard of conduct creates a discrepancy between the law and investors' reasonable expectations."

- **A misunderstanding of Dodd Frank Section 913**. Section 913 says clearly that, per se, commissions do not breach a uniform standard. In RBI, the SEC offers a very broad interpretation of 913 and writes, *"(So, that) We believe … the overall intent of Section 913 (was not to) prohibit, mandate or promote particular types of products or business models (but to preserve) … investor choice among such services and products and how to pay for these services and products. (e.g. by preserving commissioned-based accounts, episodic advice, principal trading and the ability to offer only proprietary products to customers)" (49).*

- *We use language that we believe is "the underlying intent of Section 913; that a BD should not put its interest ahead of the retail customer's…' The BDs interests, "Can and will inevitably exist, but these interests cannot be the predominant motivating factor behind the recommendation" (50).*

- **A new definition of "neutral."** *The SEC proposal stresses that the intent is NOT, per se, to prohibit a list of established conflictual recommendations, (page 53), but, at the same time, "We are also not saying that these practices are per se consistent with' the proposed best interest standard. (page 54) these practices are permissible "To the extent that the BD "Satisfies the specific requirements of RBI" (54).*

- **More expensive (for the customer) and profitable (for the broker) products are "neutral."** *To recommend a more expensive product over "another reasonably available alternative", a reasonable basis for doing so must be provided. This includes when a BD recommends a "more remunerative" product or strategy. And, "This does not mean that a BD could not recommend the more remunerative of the two reasonably available alternatives..." (56).*

- *"RBI diverges from the recommendation of (Section 913) in that it does not propose to establish a uniform standard fiduciary standard of conduct" for IAs and BDs), but focuses on establishing a "best interest" obligation for BDs (62).*

- **Brokers can just do it.** *To mitigate conflicts, the RBI "Would leave broker-dealers with the flexibility to develop and tailor" policies and procedures that include "conflict mitigation measures, based on each firm's circumstances." Depending on the BDs assessment of these factors, "more or less rigorous demanding mitigation measures … may be appropriate" (179).*

In describing best interest, the SEC highlights and explains some important principles. These include:

One, customers' interests do not come first. They come in (perhaps a distant) second. A broker's customer interests do not come first, ahead of the interests of the broker. RBI does not require that brokers put customers' interests first. It does require a broker to not put his interest ahead of the interests of his customer. This is an important difference. Though it is not stated and explained, RBI permits the interests of the broker and the interests of the customer to be treated alike. That is equivalently or equally. This lesser standard has implications. It means compliance may only require a showing that the interests are treated the same – or "tied". That is in a manner that balances the interest of the broker, manufacturer (or issuer) and customer.

FINRA speaks of balancing customer and firm interests elsewhere. "In addition to conflicts related to selling, FINRA is also concerned with how manufacturing firms handle conflicts of interest that may be inherent in a product. … to mitigate conflicts, issuers with affiliated calculation agents should establish governance and supervisory review processes …. These processes should be transparent and provide for the (emphasis added) *balancing of investor and firm interests*." This is FINRA.[29]

Brokers' customers' interests do not come first. The proposal suggests they are a distant second. The SEC embraces the view that a "uniform" standard means the standard is "business model neutral." This should mean that a standard not favor brokers over advisers or advisers over brokers. Well, not exactly, says the SEC. The RBI proposal cites the 2011 SEC staff study, which states a "neutral" uniform standard "should not prohibit, mandate or promote" any particular products or business models.[30]

The key language is to "not prohibit, mandate or promote" products or business models. Such language suggests that a "neutral" standard for advisers and brokers cannot be prejudicial against conflictual products or practices. These practices include compensation schemes designed to make brokers' recommendations biased, based on commissions, third party payments, or concealed incentives. In accepting this language, broker practices designed to be conflictual and opaque are branded as equal to practices designed to minimize conflicts and maximize transparency. Concretely, this 'logic' suggests that having COIs is actually favored over not having COIs.[31]

Two, conflicts get respect. Eliminating conflicts (as opposed to disclosing conflicts) is neither preferred nor even deemed best for customers. The RBI proposal claims to preserve investor choice. This means broker conflicts should not be uniformly eliminated. No conflictual recommendation is, per se, disallowed. To overcome this presumption, says RBI, only requires showing that the conflict is not a "predominant motivating factor" (whatever that means) behind a recommendation (50). SIFMA effectively encourages conflicts, writing:

[29] FINRA Report on Conflicts of Interest, 2013, http://www.finra.org/sites/default/files/Industry/p359971.pdf at 22.
[30] https://www.sec.gov/news/studies/2011/913studyfinal.pdf at 113.
[31] This is how. The words, "prohibit," "mandate," and "promote" matter. It's one thing to, per se, "not prohibit" proprietary products as evident in Dodd Frank Section 913. It is a very different matter to disallow any particular business model practice from being mandated or prohibited. Further, it is even more extraordinary to disallow any particular practices from being urged or promoted. Quite simply, consistent with this provision, RBI policies or procedures cannot require, much less urge, any practice associated with one business model over a practice associated with another business model. These policies and procedures can only be voluntarily agreed to.

> *The best interest of retail customers requires preserving the choice among services and products offered by their financial services provider. In order to maintain retail customer access to a broad array of beneficial products and services offered by broker-dealers that may exceed those offered by investment advisers, the uniform standard of care must be "business model neutral" and provide for investor choice as to how to pay for the various products and services.*[32]

Three, both high and low investment costs are deemed to be equal before RBI. High investment costs are not, per se, deemed worse for investors; low investment costs are also not, per se, deemed better. They effectively have equal status. Neither is, per se, presumed preferable. Recommendations that are more expensive (for the customers) or more remunerative (for brokers) do not, per se, lack presumption. A broker needs to provide a "reasonable basis" for any recommendation and this should explain its benefits to the customers.

Four, BDs can just do it. RBI explicitly states that BDs need no guidance or uniform requirements or training in order to craft policies and procedures reasonably designed to apply the rule, including "conflict mitigation measures."[33] They can just do it.

"Disclosure" in the RBI

It is difficult to overstate how broad a consensus there is that conflict disclosure is generally ineffective in protecting investors in a brokerage or advisor relationship. This view is widely accepted in academic, policy and practitioner circles, as Jason Zweig of the Wall Street Journal notes.[34]

The key question on RBI may be, "How central is disclosure to addressing conflicts in the RBI?" The SEC notes that "financial incentives can create conflicts of interest that may be difficult, if not impossible, to effectively manage through disclosure alone, or to eliminate" (177). The SEC partly draws on PIABA's August 11, 2017 comment letter in footnote 305. The pertinent passage is:

> *Disclosure has been the hallmark of the securities industry. However, the effectiveness of disclosure is questionable. For example, studies in the field of behavioral economics have been applied to disclosure issues. There are a number of cognitive biases that may influence investors, including "the hindsight bias, the (flawed) reliance on heuristics (including the availability heuristic), the presence of overconfidence and over optimism, the endowment effect (and other framing related biases), and the confirmation bias." Other research has argued that "not only may disclosure of conflicts of interest provide no additional protection to beneficiaries, but it may actively encourage both beneficiaries and advisers to ignore the conflicts." Other studies have found the disclosure may lead to more biased advice. For example, if a broker has "just done something upfront and honest (disclosed conflicts of interest), they may tend to*

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32 SIFMA Comment Letter to the SEC Re: Study Regarding Obligations of Brokers, Dealers, and Investment Advisers, Study, August 30, 2010, at 7, http://www.sifma.org/wp-content/uploads/2017/05/sifma-submits-comments-to-the-sec-on-obligations-of-brokers-dealers-and-investment-advisers.pdf

33 RBI, at 306. ("The proposed rule does not stipulate specific conflict mitigation measures.")

34 Zweig, Jason (July 27, 2018), https://blogs.wsj.com/moneybeat/2018/07/27/no-one-needs-paper-piles-sec-should-get-smart-about-broker-disclosure/

unconsciously give themselves moral license to take a little advantage of their customers.''[35]

There are numerous well-documented concerns that raise questions regarding disclosure.
Still, the SEC draws heavily on FINRA's Conflicts Report[36] in shaping its view of reasonably designed policies and procedures to identify material conflicts. Here, FINRA says "[t]he U.S. regulatory regime relies heavily on disclosure to customers as a tool to mitigate conflicts."[37] This language directly equates disclosure with mitigation. While the agency offers no clear definition of *conflict mitigation* in RBI, the predominant importance of disclosure in the proposal stands out.

The SEC does not provide guidance on mitigating conflicts arising from financial incentives or any uniform requirements, but rather chooses to provide a "non-exhaustive list of [six] potential practices…to promote compliance with RBI" (181). The six examples of "potential practices" that BDs "generally should consider incorporating…as relevant into their policies and procedures to promote compliance with [RBI]" are on pages 182 and 183. Here are comments on the first five:

The first, third, and fourth example include "avoiding" and "eliminating" compensation that encourages sales contests, as well as implementing sufficient enforcement mechanisms for ensuring that such practices are avoided/eliminated. While these examples are good steps forward, it's not clear how much a step without further explanations. What's a "disproportionate" increase in compensation versus a "proportionate" increase? Further, "eliminating compensation incentives" is a clear good step.

The second example requires that BDs "minimize[e] compensation incentives for employees to favor one type of product over another." This is good if this is a material reduction. Why not simply eliminate? Certainly, it falls short of what a Best Interest Standard should require of BDs and their employees. "Minimizing" instead, represents a vague or unclear strategy of mitigation. Compensation incentives are the very foundation of BD culture. They define sales brokers and are one of the core components that separate BDs from RIAs.

The fifth example suggests BDs might "[adjust] compensation for registered representatives who fail to adequately manage conflicts of interest." It's not clear what this may mean, but it raises the question of whether a serious breach has occurred. A breach of fiduciary duty of care if, for example, in relationship of trust and confidence or a discretionary account? Such violations may warrant a more stringent sanction or response from BDs than "adjusting compensation".

The thrust of these practices appears to be in the right direction. Still much uncertainty remains. Their likely force will depend on how they are defined and enforced, and the guidance and training provided.

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[35] Letter from PIABA to the SEC in Response to Chairman Clayton's Request for Public Comment, August 11, 2017, at 18, https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2215713-160615.pdf
[36] As on pages 18, 173, 179, and 181.
[37] FINRA Report on Conflicts of Interests, October 2013, at 13, http://www.finra.org/sites/default/files/Industry/p359971.pdf

RBI Does not Define what *Mitigating* conflicts of interest means.
Nor does it require, much less urge or recommend, any particular mitigation measure.

The SEC refrains from giving uniform guidance on what conflict mitigation measures in policies and procedures BDs should create, implement, and enforce. It also does not define mitigation.

Instead, it opts to "leave BDs with flexibility to develop and tailor" their own conflict mitigation measures for financial incentives and does not mandate "specific conflict mitigation measures" (306). The SEC believes such measures should vary, dependent "on a variety of factors related to a BDs business model (such as the size of the BD, retail customer base, the nature and significance of the compensation conflict, and the complexity of the product)" (179). Absent any uniform guidance, or definition or particular requirements, firms are left to craft their own definitions for such terms.

Given this flexibility one would think a discussion of mitigation purposes and objectives may be offered. It is not. Nowhere in RBI does such a discussion exist. Not under the Conflict of Interest Obligations section ranging from pages 166 to 195, nor under the Costs section from pages 306 to 314 where mitigation measures are mentioned.

FINRA does not define Best Interest

FINRA does not define 'best interest.' Q7.1. of FINRA Rule 2111 (Suitability) FAQ[38] asks what it means "to act in a customer's best interests." The guidance? That a broker must make only those recommendations that are consistent with a customer's best interest and this "prohibit[s] a broker from placing his or her interests ahead of the customer's interests." Then, FINRA gives a list of egregious examples of conduct that obviously fail a suitability test.

Relatedly, the SEC's January 2011 Study on IAs and BDs[39] cites three cases[40] to affirm that a broker-dealer is generally required "to make recommendations that are consistent with the best interests of his customer." Upon reviewing the language pertaining to 'best interest' in these three cases, and other SEC cases cited, we see; namely:

- The Broker recommendation must be consistent with the customer's best interest and financial situation and needs.[41]
- The Broker has an obligation to not recommend a course of action clearly contrary to best interests of the customer (or, as is in some language, with the customer's financial situation), regardless of whether there is full disclosure.[42]
- The Broker must have reasonable grounds for believing a recommended transaction is not unsuitable for a customer.[43]

Proposed RBI confirms this analysis. That the BDs "duty of fair dealing," does "not explicitly [require BDs] to make recommendations that are in a customer's 'best interest'" (12, 14). The SEC notes:

> *While not an explicit requirement of FINRA's suitability rule, FINRA and a number of cases have interpreted the suitability rule as requiring a broker-dealer to make recommendations that are "consistent with his customers' best interests" or are not "clearly contrary to the best interest of the customer." (14)*

After reviewing FINRA's response, and following the SEC's citations, it's clear that both FINRA and the SEC offer no definition of 'best interest' that is separate and distinct from the Suitability Rule. The seven relevant SEC cases affirm 'best interest' for brokers is understood as no different from the suitability standard. 'Best interest' refers to recommendations that are consistent with a customer's financial situation and needs, and are not egregiously inconsistent with them ("unsuitable for a customer"). The bottom line: the suitability standard is effectively rebranded as a best interest standard.

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38 http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq

39 https://www.sec.gov/news/studies/2011/913studyfinal.pdf

40 The SEC cases are In the Matter of the Application of Raghavan Sathianathan, In the Matter of the Application of Dane S. Faber, and In the Matters of Powell & McGowan, Inc.

41 In the Matter of the Application of Raghavan Sathianathan, Exchange Act Release No. 54722 at 21 (Nov. 8, 2006); In the Matter of the Application of Dane S. Faber, Exchange Act Release No. 49216 at 23-24 (Feb. 10, 2004); Wendell D. Belden, Exchange Act Rel. No. 47859 (May14, 2003), 80 SEC Docket 699, 704; Daniel Richard Howard , Exchange Act Rel. No. 46269 (July 26, 2002), 78 SEC Docket 427, 430

42 In the Matters of Powell & McGowan, Inc., Exchange Act Release No. 7302 (Apr. 24, 1964); John M. Reynolds , 50 S.E.C. 805, 809 (1992)

43 Wendell D. Belden, Exchange Act Rel. No. 47859 (May14, 2003), 80 SEC Docket 699, 704; Jack H. Stein, Exchange Act Rel. No. 47335 (Feb. 10, 2003), 79 SEC Docket 2276, 2280

RBI's premises and principles are important;
they suggest how Reg RBI may be implemented

Core premises and principles of RBI reflect the view at the SEC that brokers and advisers have merged to be "indistinguishable." Still, important differences are either ignored or glossed over. No significant note is made of "incidental advice" in contrast to fiduciary advice; or that relationships of two differ from relationships of three; or that their contrasting legal, contractual and business obligations matter.

Two sets of premises stand apart in defining RBI.

One, RBI worries that if brokers' eliminate conflicted recommendations they will lose revenue and their customers will be harmed by not buying these products

RBI rejects the rationale for and principles in the 40 Act. It rejects the basic idea that conflicts debilitate objective advice and harm clients. In fact, RBI argues the opposite side. (274). The argument is that eliminating conflicts harms brokers and it harms brokers' customers. The reason is brokers will lose commission revenue. If brokers lose these commissions, they will not spend "effort" needed for "high quality" advice. This in turn "costs" their customers lower quality advice and with less "choice" because a broker will stop recommending conflicted products.

Two, RBI restricts how the SEC can assist BDs to build a compliance program that advances ethical conduct standards. It fails to help BDs understand what best interest means

On the policies and procedures, RBI does not provide requirements or offer uniform guidance. BDs have flexibility to "develop and tailor" policies and procedures, based on each firms likes. (SEC's view that Dodd Frank Section 913 matters. It says a uniform standard (and RBI) cannot "prohibit, mandate or promote" any particular products or businesses.)

RBI does not define "mitigation"; rather, it offers measures BDs "generally should consider."
RBI does not define "best interest" (BI); rather, it implies a separate broker BI standard exists.
RBI cites FINRA, though FINRA does not define "best interest" different from "suitability".
Brokers must make recommendations consistent with this undefined BI standard.

This flexibility means BDs will write policies and procedures on their own to meet an undefined RBI BI standard. What is a BD that meets the FINRA BI standard to do? What it knows. This may be why Commissioner Stein suggests in her statement that RBI is better called, "Regulation Status Quo."

RBI has just about literally removed the word "ethics" from the conduct standard language. Within the 408 pages, and 125,993 word RBI document, we find the word mentioned three times, and not regarding the RBI proposal.

RBI represents a major step towards codifying in SEC Rulemaking principles and practices that further deemphasize conflicts of interest and codes of ethics and differences between brokers and advisers, while advancing disclosure as the bulwark of investor protection.

What the Best Interest Standard Functionally Equivalent to the Fiduciary Standard Should Include on COI

Is a Best Interest Standard the same as the Fiduciary Standard?

The answer to this question is straight forward. It is synonymous with *fiduciary*. As professor Ron Rhoades argues, the phrase best interest "Has been reserved under the law for a fiduciary-client relationship." Rhoades notes Black's Law Dictionary defines fiduciary duty as "A duty to act with the highest degree of honesty and loyalty toward another person and in the best interest of another person." He also cites professor Deborah DeMott who notes that fiduciary duties, "Oblige him to further the beneficiary's best interest." Rhoades concludes that "The use of the term "best interest is found in numerous judicial decisions to describe the duty of a fiduciary… (finding, in a recent search of U. S. case law data base) 963 judicial decisions in which the terms "fiduciary" and "best interests" appeared in the same decision."

Rhoades further cites examples where an industry insurance representative acknowledged the term best interest to relate to fiduciary obligations and a member of Congress asked a panel of industry executives all replied "Yes" when asked, "Does everyone agree that a best interest standard means a best interest fiduciary standard?"[44]

What a Best Interest Broker Standard Should Include

Fiduciary rules are vital. Stringent fiduciary duties are vital for relationships of trust and confidence. Fiduciary law exists to restrain the conduct of experts who render socially important services or advice in relationships of trust and confidence. Fiduciary duties serve to mitigate the knowledge gap or information asymmetry that separates the two parties. The fiduciary is obligated to be loyal, render due care and act in utmost good faith. The fiduciary must adopt the client's ends. The need for 'investment counselors' to eliminate conflicts to deliver sound advice is stressed by leaders who helped craft the Investment Advisers Act of 1940. Understandably so. Conflicts undermine trust and fiduciary conduct aims to nurture *trust,* the core pillar on which capital markets and the market economy depend.

As law professor Tamar Frankel notes, "The strictness of fiduciary law conflict-of-interest rules depends mainly on the level of entrustors' (clients) risks from the fiduciaries abuse of trust."[45] Fiduciary duties increase as the knowledge gap widens, and the gap between brokers and retail investors is widely acknowledged as large. Research reveals retail investors are sharply limited in their understanding of investing, markets and the role of advisors and brokers, suggesting a firm legal basis for applying the most stringent fiduciary duties.[46]

[44] See, "Why Insurance Companies and Wall Street Should Not Be Permitted to Redefine the Term "Best Interests," http://scholarfp.blogspot.com/ Feb. 2, 2018.
[45] Tamar Frankel, Fiduciary Duties of Brokers-Advisers-Financial Planners and Money Managers, Boston University School of law Working Paper No. 09-36, August 10, 2009, Revised February 17, 2010. http://www.bu.edu/law/workingpapers-archive/documents/frankelt081009.pdf at 6.
[46] Institute for the Fiduciary Standard 2012 letter to SEC Chairman Schapiro, http://www.thefiduciaryinstitute.org/wp-content/uploads/2013/02/913ConcernsApril92012final.pdf

Conflict management or mitigation is not "easy".

Casual disclosure of conflicts, alone, fails. It fails to "neutralize" conflicts. The DOL notes, "Disclosure alone has proven ineffective to mitigate conflicts in advice."[47] Research from management professor, Daylian Cain and colleagues, explains why investors do not generally discount conflicted advice from disclosures, and why disclosure can actually be harmful to investors by legitimizing bad advice.[48] Cain also explains this "perverse" consequence.[49]

Eliminating or disclosing and mitigating conflicts are not practices with which brokers generally have training and experience. This reflects the current different conduct standards. Policies and procedures should be designed to reflect this fact. These policies and procedures are, by their nature, are challenging to meet. They need to be learned to be clearly understood and become the backbone of the best interest standard. They need to include more narrow "conduct-specific" mandates.

"Gene Gohlke, former Associate Director of OCIE, once quipped, 'they are everywhere', (such that) clashes of interests do not lend themselves to easy management,"[50] writes attorney Michael Koffler. Koffler's sober assessment may understate the difficulty. Research and experience both suggest client biases complicate addressing conflicts. Still, to help brokers or advisers "neutralize" conflicts' harms, here are five steps that the SEC should require.

1. <u>Disclose in writing all material conflicts of interest.</u> Material conflicts are conflicts that, according to the SEC, "Might affect (the client's) decision whether or how to act."

2. <u>Prohibit certain compensation practices.</u> Consumer Federation of America's Roper and Hauptman point to practices that "Can reasonably be expected to cause advisers to base recommendations on their own financial interests rather than the best interests of the customer."[51] These include sales quotas for proprietary products, differential compensation, compensation based on a "retroactive, ratcheted payout grid" and upfront signing bonuses.

3. <u>Require compensation that's transparent, reasonable and level</u>. The Institute Best Practices Board discusses how these three criteria can reduce the scale and scope of conflicts, especially noting the importance of full and complete transparency on 'all-in' fees and expenses.[52] Require a good-faith estimate of all-in costs of fees and investment expenses at the outset of an engagement; require an annual accounting of a prior year's all-in costs upon a request.(See examples in Appendix B.)

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[47] EBSA, DOL, Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice, 81 Federal register, 20946 (April 8, 2016).
[48] See Rostad, Knut and Fogarty, Darren, "Fiduciary Duties Advanced in 2015…." http://www.thefiduciaryinstitute.org/wp-content/uploads/2016/02/Fidcuiary-Duties-in-2016-Jan-28.pdf, at 6.
[49] http://www.thefiduciaryinstitute.org/wp-content/uploads/2017/07/Daylian-Cain-Knut-NYU-Final.pdf
[50] Koffler, Michael, Modern Compliance 2017, "Conflicts of Interest," at 38.
[51] Roper, Barbara and Hauptman, Micah, CFA Letter to Chairman Jay Clayton, September 14, 2017, https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2447346-161075.pdf, at 68.
[52] Institute for the Fiduciary Standard Best Practices Board, Best Practices for Financial Advisors Guidance, Attachment A, December 2016.

4. Require certain disclosure on key issues. In RBI the SEC overlays the values and practices of the commercial market place on relationships of trust and confidence. This raises questions the SEC should address. For example, certain facts about broker-dealers should be disclosed and may include: a) the fact that broker-dealers are hired by issuers to offer and sell securities. b) that they get paid only if they are successful in their sales efforts. c) that their "advice" must be "solely incidental" to their distribution services performed on behalf of the issuer. d) that the forgoing means their allegiance is primarily to their issuers.

5. Require rigorous disclosure and 'informed consent' protocols. Disclosure means very different things to different people. Disclosure protocols vary widely. A casual oral disclosure alone (with no other provisions) is weak, while a plainly written disclosure explained in person and requiring written consent that is informed and independent is far more rigorous.

Disclosure and Informed Consent Protocols. The steps required to fulfill the stiff requirements of the Advisers Act of 1940 are far more than mere that casual "disclosure" and "consent." Professor Ron Rhoades explains how these acts are "in and of themselves, wholly insufficient to prevent a breach of fiduciary obligations." If these are insufficient, what else is required?

Rhoades notes disclosure must be detailed, include essential material facts and be timely and written plainly. Further, the adviser must be responsible for ensuring the client understands the conflict so that his/her consent is informed. Also, the transaction must be deemed to be fair.[53] In summary, this means:

Disclosures must be affirmative. The adviser or broker is responsible for proactively delivering disclosures. Professor Rhoades notes, "Clients do not generally possess a duty of inquiry."

Disclosures must include "specific facts". The SEC emphasizes that conflicts must be disclosed "with sufficiently specific facts so that the client is able to understand (them) … and can give informed consent to such conflicts or practices or reject them." The "specific facts" requirement is important. Research underscores that many clients today are cost conscience of fees and expenses and seek to learn what they pay in investment costs. It suggests "specific facts" should include a written good faith estimate of total fees from the transaction paid to the adviser or broker and the firm by the client and third parties.

Disclosures must be understood. This means that while specific facts are necessary, alone they may be insufficient. The nature of how the disclosure is written and delivered also matters. For example, financial planner Cheryl Holland notes that reviewing a disclosure with a client can enhance client understanding.[54] Disclosure must "Lay bare the truth … in all its stark significance", as Justice Cardoza wrote. Further, the Commission noted, "In the Matter of: Arlene W. Hughes", there is no one appropriate disclosure method, no 'one size fits all' because "The method and extent of disclosure depends on the particular client involved…. "[55] In the case, former SEC Chief Counsel, Louis Loss, underscored that the fiduciary obligation cannot be delegated to a client through a disclosure, as he

[53] http://scholarfp.blogspot.com/2013/05/musings-custodial-support-services.html
[54] 2017 Frankel Fiduciary Prize Award Program: Panel Discussion on Fiduciary Duties, "Panel of Industry Leaders Discuss Fiduciary Duties at a Tipping Point in 2017, Available: https://www.youtube.com/watch?v=9z8-oZsVzzA&feature=youtu.be
[55] Commission decision, In the Matter of: Arlene W. Hughes. https://www.sec.gov/litigation/opinions/ia-4048.pdf

said, "In all cases, however, the burden is on the firm which acts as fiduciary, to make certain that the client understands."[56]
Informed consent must be attained. Written client consent must be "clear and specific to the transaction" and intelligent, independent and informed."

The transaction must be fair and reasonable. Even with client consent, "the proposed recommendation must be fair and reasonable, because as professor Tamar Frankel writes, "Courts will generally not enforce an unfair and unreasonable bargain."[57]

The bottom line is that mere "disclosure" and "consent" is insufficient. The broker or adviser bears responsibility for client understanding of what the conflicted transaction means for the broker or adviser and client, such that a truly informed consent – or rejection – may occur.

Conflict management methods should be tested. Research and experience underscores that effective conflict management and consent protocols are difficult to achieve. Client biases and shortcomings and lack of substantial financial knowledge present impediments to reasonably dealing with conflicted advice from a "trusted" adviser or broker. As such its' important the Commission test any disclosure management methods before implementing them.

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[56] https://www.sec.gov/news/speech/1948/031648loss.pdf
[57] Frankel, Tamar, *Fiduciary Duties as Default Rules*,
http://www.bu.edu/lawlibrary/facultypublications/PDFs/Frankel/Fiuduciary%20Duties.pdf at 9.

RBI: Care Obligation

Adopt the DOL Rule description of best interest:

"Investment advice is in the ''Best Interest'' of the investor when the Adviser and Financial Institution providing the advice act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party."

This means, among other things, that the standard should not only be applied "at the time" of the recommendation, (which could be argued to be just a few seconds). It also means the standard is not putting the interest of the retail customer *equivalent* to the interest of the broker, but *ahead* of the broker. This also means the standard is not directed to "at least some" retail customers or any "particular" retail customer

Clarify "incidental" advice

Separately, RBI raises an important issue of incidental advice. At minimum, RBI should clarify that, per se, advice on a discretionary account requires registration as an investment adviser and meeting the obligations of the Advisers Act.

Form CRS Relationship Summary

In the Form CRS Relationship Summary, proposed hypothetical disclosures describing advisers and brokers is offered. To review and offer specific recommendations, the Institute recruited The Plain Language Group to weigh in on this disclosure. The Plain Language Group is experienced in financial services. The comments and recommended alternative of its principal, Deborah Bosley are shown in Appendix A.

Sincerely,

Knut A. Rostad

Knut A. Rostad
President

XC:

The Honorable Kara Stein, Commissioner
The Honorable Hester M. Pierce, Commissioner
The Honorable Robert J. Jackson, Jr., Commissioner

the PLAIN LANGUAGE GROUP

Making written information easy to understand.

"Explaining the differences between broker dealers and investment advisors means using language that is clear, concise, and accurate. A hypothetical comparison must always keep the investor in mind. This is what we have done in the example attached as Appendix A. In contrast, what the SEC has presented as a hypothetical description is overly complex, redundant, and (at times) vague about the differences. That means the investor is left to figure out the distinctions instead of being presented with information that makes their choices easy."

- Deborah S Bosley, Ph.D., Owner and Principal,
The Plain Language Group
http://www.theplainlanguagegroup.com/

Institute for the Fiduciary Standard

Appendix A: The Plain Language Group's Form CRS Relationship Summary Hypothetical Disclosure

Broker or Adviser. Which is Right for You?

	Broker-Dealer Services, Brokerage Accounts*	Investment Advisory Services, Advisory Accounts*
What kind of advice do we give?	By law, if you open a brokerage account, we only give you incidental advice related to the products you buy through us.	By law, if you open an advisory account, we must give you fiduciary advice in your best interest at all times.
Who do we represent?	We represent issuers or underwriters (called "manufacturers") who sell financial products. We do not represent you. Our relationship is three parties: manufacturers, ourselves, and the customer.	We only represent you. You pay our fees and we advise you. Period. Ours is a two-party relationship.
Why?	Brokers are hired and trained to sell products offered by issuers or underwriters (manufacturers).	Advisers are hired and trained to give fiduciary advice.
How are we paid?	**Commissions.** We get commissions when you buy or sell financial products, based on the product and what we negotiate. Sometime we also get payments from third parties. Ask us what your 1st year all-in fees/costs will be.	**Fees.** We generally get a fee, that's hourly, fixed, or based on the value of the cash and investments in your advisory account(s). Fees depend on our services and what we negotiate. Ask us what your 1st year all-in fees/costs will be.
What about conflicts of interest?*	Because manufacturers pay us to sell financial products to you, we have built-in conflicts that may influence our recommendations to you.	When we are paid fees just by you, we don't have conflicts with manufacturers. If we have a conflict, we'll explain it so you can understand it. You can decide if you want to work with us.
What do we do about conflicts?	We must tell you about the conflict's and reduce the conflict's harms or eliminate it.	We are paid by you to give you advice. Still, if we have a conflict, we will tell you so you understand what it means and make sure it's okay for you to proceed.
Where do you go for additional information?	For more information about our brokers and services, 1) visit Investor.gov or BrokerCheck (BrokerCheck.Finra.org), 2) our website (SampleFirm.com), and 3) your account agreement.	For more information on advisory services, ask us for our Form ADV brochure and any brochure supplement.
How do you research our firm?	Visit Investor.gov for a free, simple search tool to research our firm and our financial professionals.	Visit Investor.gov for a free, simple search tool to research our firm and our financial professionals.
How do you report a problem with our firm?	To report a problem to 1) the SEC, visit Investor.gov or call the SEC's toll-free investor assistance at (800) 732-0330; 2) FINRA, call [ ]. If you have a problem with your investments, account or financial professional, contact us in writing at [ ].	

* For a discussion on how the SEC addresses conflicts of interest, see: http://www.thefiduciaryinstitute.org/wp-content/uploads/2015/08/SECandConflictsApriil62015.pdf.

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Appendix B: Fee and Expense Disclosure Examples

Figure 1.1: FirsTrust Investment Expenses

Chris Cannon
(386) 788-3737
chris@financialteam.com

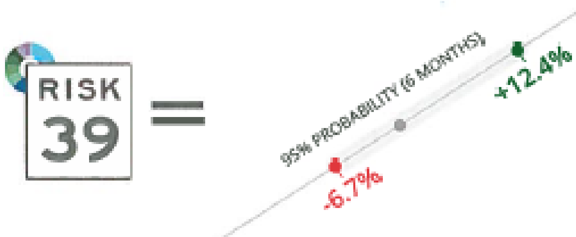
FIRSTRUST

Introduction

The Current Portfolio Report frames foundational components of the Current Portfolio's Risk Number, 95% Probability Range, and other analytics, to ensure current investment strategy alignment between the advisor and the client.

Current Portfolio

This is your asset allocation, as captured on April 30, 2018.



DISTRIBUTION RATE * 1.62% (annual)

EXPENSE RATIO ** 0.24% (annual)

The Risk Score of 39 and the 95% Probability Range of -7% to +12% was calculated using a long-term average of 10.4% for the S&P 500, 0bps change in the Ten Year US Treasury Rate, and correlation and volatility data from 2008 to present. Riskalyze uses actual historical data to calculate the statistical probabilities shown. For securities calculated using Average Annual Return, the Average Return will be calculated using actual price history from June 2004-present or inception. We calculate the annualized return number as (final price / initial price) ^ (1 / number of years) - 1. Riskalyze does not provide investment analysis on investments with less than 6 months of historical performance. In instances where an investment's inception is more recent than January 1, 2008 and greater than 6 months Riskalyze will use correlation statistics from the investments actual trading history to extrapolate missing volatility data. In most cases the extrapolation calculation increases the risk presented in the investment analysis as a means of protecting the investor. Investments with an inception more recent than January 1, 2008 are highlighted with an information icon. The Six Month 95% Probability Range is calculated from the standard deviation of the portfolio (via covariance matrix), and represents a hypothetical statistical probability, but there is no guarantee any investments would perform within the range. There is a 5% probability of greater losses. Riskalyze does not use any Monte Carlo or any other type of simulations. The underlying data is updated as of the previous day's market close price, and the results may vary with each use and over time. The investments considered were determined by the financial representative. IMPORTANT: The projections or other information generated by Riskalyze regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. These figures may exclude commissions, sales charges or advisory fees which, if included, would have had a negative effect on the annual returns.

* The distribution rate is derived by summing the trailing 12-months' distributions (dividends, distributions from

borrowing, return of capital, etc) and dividing the sum by the last month's ending NAV. It does not include capital gains distributed over the same period.

** The percentage of fund assets used to pay for operating expenses and management fees, including 12b-1 fees, administrative fees, and all other asset-based costs incurred annually by the underlying funds, except brokerage costs.

FirsTrust, LLC (FirsTrust) is a Registered Investment Adviser (RIA) with the Securities & Exchange Commission (SEC) and compliant with the requirements of each state in which services are offered. FirsTrust is compensated exclusively by client fees pursuant to a written Agreement for services, and offers no solicitation, representation, or warranty, regarding the accuracy, timeliness, suitability, or completeness of third party illustrations. For more information about FirsTrust, please call 1-800-585-9888. For regulatory information, please contact the SEC or the State securities regulators.

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Figure 1.2: Hogan Financial Investment Expenses

Hogan Financial

John A. & Jane B. Sample
As of March 31, 2018

Dimensions of Your Portfolio - Risk & Cost

Savvy investors focus on what they can control.

The areas where investors have control is risk and cost.

Here is data on the risk and cost of your portfolio.

Risk: *This is the mutually agreed upon targeted risk level for your portfolio. We are accountable for keeping your portfolio pulled to this level of portfolio risk.*

Objective: Moderate

Description: An investment portfolio characterized by moderate risk. This objective is for an investor who accepts a fair degree of risk and is looking to exceed long-term inflation by a fair margin (e.g. 3-5% over the long term). The investor understands and is comfortable with the fact that short-term volatility is a price to be paid for higher long-term returns. General Allocation: Portfolio will be allocated among equities, fixed income, alternatives, and cash, with generally 41%-60% allocated to equities.

Cost: *These are the three layers of your financial expenses. The first two expenses are included in portfolio performance data. The last is not.*

Mutual Fund Expense[1]: (as a % of Your Performance Portfolio)	0.22%
Brokerage Firm Transaction Fees[2]: (as a % of Your Performance Portfolio)	<0.01%
Hogan Financial Advisory Fee[3]: for Financial Planning & Portfolio Management (as a % of Your Whole Portfolio)	0.35%
Previous quarter's advisory fee:	$3,000
Fee calculation method:	Flat Fee

[1] Mutual Fund Expense: The weighted average expense ratio for Your Performance Portfolio, calculated using the expense ratio reported by the mutual fund company for the current quarter for each mutual fund in your portfolio applied to the market value of each fund.

[2] Brokerage Firm Transaction Fees: The transaction fees levied by your account custodian whenever you buy or sell an investment.

[3] Hogan Financial Advisory Fee: Our fees for advising, coordinating, implementing, and reporting on financial planning and investment management. The stated fee reflects your most recent quarterly fee annualized, expressed as a percentage of Your Whole Portfolio, i.e. including all of your long-term investment accounts regardless of whether or not consolidated performance reporting is possible.

Figure 1.3: Abacus Planning Group Investment Policy Statement

Investment policy guidelines — abacus smart financial decisions

These investment policy guidelines document your decisions and directives for Abacus Planning Group, Inc. to manage your investment portfolio. You have directed Abacus to consolidate the following accounts for purposes of asset allocation, rebalancing and performance reporting.

Client account information	account type	account number
Unit Name PSR and Primary Address City, State ZIP+4	Information	Numbers

Objectives

- To achieve a long-term, real rate of return, i.e., the return less income taxes, expenses and inflation, primarily through capital appreciation. Current income is of secondary concern.
- To preserve principal through reasonable efforts, but preservation of principal shall not be imposed as a requirement of individual investments.
- To reduce risk by prudent diversification across markets, managers and investment styles.

Management

Abacus shall be responsible for the following portfolio activities:

- Advising you about the selection and allocation of asset classes.
- Identifying specific investments within each asset class.
- Monitoring the performance of all selected asset classes and specific investments.
- Preparation and presentation of appropriate performance reports.

Directives

- You plan to make future contributions into your portfolio of $_____.
- To pay for your short-term financial objectives, you plan to take withdrawals from your portfolio of no more than $_____ annually, adjusted for inflation, in addition to the Abacus financial planning fee.
- To ensure that you will have sufficient cash available in the event of an unforeseen emergency, you direct Abacus to have liquid investments (exchangeable into cash within one month or less, without loss of market value) in the amount of $_____ in the _____ account.
- You direct Abacus to implement this policy [X] immediately [ ] by spreading transactions over a _____ month period, dollar cost averaging purchases or sales.
- You direct Abacus to use no-load, low annual expense managers whenever prudent.
- You direct Abacus not to time the market or select individual stocks.

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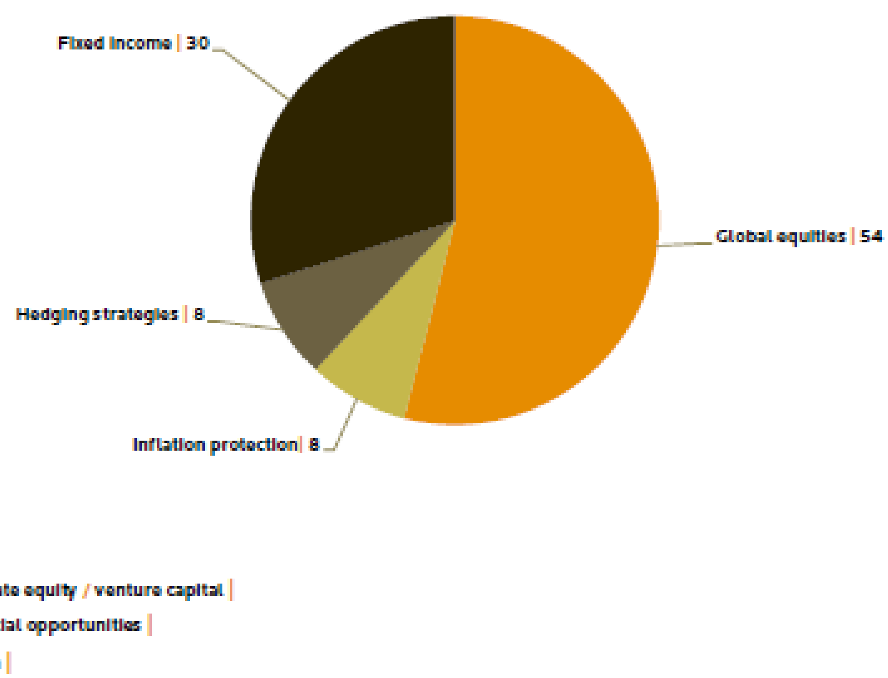
Investment policy guidelines   abacus smart financial decisions

Asset allocation | moderate growth

This portfolio is appropriate for investors with a time horizon of 7 to 10 years. This portfolio is restricted to investing in the asset classes listed below, unless otherwise authorized in writing by you.

	Target%	Minimum %	Maximum %	Current %
Global equities				
US Large	**18**	9	28	
US Small	**9**	4	14	
International Large	**12**	6	18	
International Small	**7**	3	14	
Emerging Markets	**8**	4	15	
Inflation protection	**8**	4	25	
Hedging strategies	**8**	4	15	
Fixed income	**30**	15	45	
Special opportunities	**0**	0	15	
Cash	**0**	0	20	
	100			**100**

Target portfolio |



Rebalancing |

The portfolio asset class weightings will range above or below your portfolio targets due to deposits, withdrawals, and differing rates of growth among asset classes. Abacus will review your portfolio for rebalancing no less than every 90 days. Abacus will, at minimum, rebalance your portfolio if your asset class percentages deviate from the minimums or maximums noted in this document. Abacus will be sensitive to minimizing transaction fees and income tax consequences that may result from this process.

Return objectives and risk tolerance |

Abacus cannot guarantee the future performance or risk level of any individual security, asset class, or portfolio. Historical performance does not guarantee future performances. You do need, however, some reasonable process, some sensible way to forecast the future. We calculate estimated expected return, risk, and correlation coefficient of each asset class. In these calculations, we assume a U.S. equity premium of 5% and inflation of 3%. When you review what actually happens in any year, you will almost certainly observe results that differ from the average gross expected return.

Average gross expected return | %	Variability of portfolio selected | %	Maximum expected 1-yr loss | %
6.75%	–17.2% to + 30.5%	– 30.7%

	6.75	%	**Gross return** (this number includes annual interest, dividends, capital gain or loss)
–	0.60	%	Abacus investment fee
–	0.39	%	Annual projected expenses paid to the underlying managers
–	0.00	%	Transaction costs
=	**5.76**	%	**Net return**
–	3.00	%	Inflation
–	0.40	%	Taxes (your average projected income tax rate multiplied by your projected taxable yield)
=	**2.36**	%	**Real return**

Portfolio monitoring

Abacus will compare the performance of the total portfolio to the following composite benchmark: 70% Global stock/ 30% US bonds, as measured by the following indices: S&P 500 Total Return Index, MSCI EAFE Index, MSCI EAFE Emerging Markets Index, HRFX Fund of Funds Index, Barclays US TIPS Index, and Citigroup 1-3 Year Treasury Index.

Management discretion

We grant Abacus Planning Group, Inc. the right to act with full investment discretion regarding my portfolio, within the bounds of these investment policy guidelines.

Client initials ____________

Client initials ____________

Client acknowledgement

We hereby acknowledge receipt of these investment policy guidelines and agree to the guidelines set herein.

Date ____________

Client signature ________________________________

Client signature ________________________________

Abacus Planning Group, Inc. ________________________________

Figure 1.4: Abacus Investment Recommendation Expense

client name

Recommended Investment Implementation Expense

Investable Assets 6,613,590

Asset	Implement $	Trading Fee	Annual Expense Ratio	Annual Expense ($)
Schwab US Large Company	1,058,174	$25	0.03%	$317
DFA US Large Value	198,408	$25	0.27%	$536
U.S. Large Cap Equities	**1,256,582**			
DFA US Microcap	314,146	$25	0.52%	$1,634
DFA US Small Value	314,146	$25	0.52%	$1,634
U.S. Small Cap Equities	**628,291**			
Vanguard Total Intl Stock Market	558,481	n/a	0.09%	$503
Harbor International	279,240	$25	0.72%	$2,011
International Large Cap Equities	**837,721**			
DFA International Small Company	484,997	$25	0.53%	$2,570
International Small Cap Equities	**484,997**			
DFA Emerging Markets	281,078	$25	0.48%	$1,349
DFA Emerging Markets Small Company	281,078	$25	0.73%	$2,052
International Emerging Markets	**562,155**			
Vanguard Inflation Protected Securities	330,680	$25	0.07%	$231
Inflation Hedging	**330,680**			
John Hancock Global Absolute Return	529,087	n/a	1.33%	$7,037
Hedging Strategies	**529,087**			
Individual fixed income investments	992,039	spread	n/a	$0
PIMCO Total Return	462,951	$25	0.46%	$2,130
DFA Two Year Global Fixed Income	529,087	$25	0.17%	$899
Cash	0	n/a	n/a	$0
Fixed Income	**1,984,077**			
Mutual fund expenses	**$22,902**	**0.35%**		