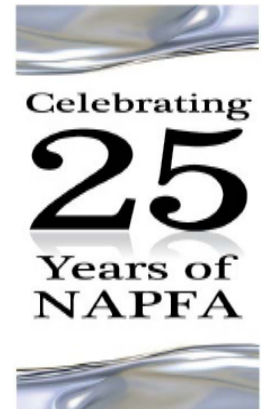




FOCUSonFiduciary™

April 15, 2008

David W. Blass, Assistant Director
Division of Investment Management
Elizabeth Osterman, Assistant Director
Division of Investment Management
Jo Anne Swindler, Assistant Director
Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549



**Re: The Difficult Task the SEC Faces After the RAND Report:
A Challenge Which Must Be Met Correctly**

Dear Mr. Blass, Ms. Osterman, and Ms. Swindler:

The National Association of Personal Financial Advisors (NAPFA) appreciates the opportunity for its representatives, Chair Tom Orecchio and member of its Industry Issues Committee, Ron A. Rhoades, to meet with you and your staff members to exchange ideas relating to the future of financial services regulation. Following that meeting certain NAPFA members conferred regarding the questions which were posed by the Commission staff. The result was a "white paper" addressing these issues, which we provide for your review and consideration.

The work you are doing is extremely important. NAPFA hopes that increased recognition will result as to the key distinctions between the various business models that exist, the importance of fiduciary status for relationships which are advisory in nature, and the importance in enhancing consumer understanding of the different roles of various financial services and product providers.

Thank you again for the opportunity to present NAPFA's ideas to your team. Should you desire anything further, please do not hesitate to contact us.

Respectfully,

Tom Orecchio
Chair, NAPFA

Ellen Turf
CEO, NAPFA

Diahann Lassus,
Chair, Industry Issues Committee

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National Association of Personal Financial Advisors' Fiduciary Oath

- The advisor shall exercise his/her best efforts to act in good faith and in the best interests of the client.
- The advisor shall provide written disclosure to the client prior to the engagement of the advisor, and thereafter throughout the term of the engagement, of any conflicts of interest, which will or reasonably may compromise the impartiality or independence of the advisor.
- The advisor, or any party in which the advisor has a financial interest, does not receive any compensation or other remuneration that is contingent on any client's purchase or sale of a financial product.
- The advisor does not receive a fee or other compensation from another party based on the referral of a client or the client's business.

NAPFA Code of Ethics

Objectivity: NAPFA members strive to be as unbiased as possible in providing advice to clients and NAPFA members practice on a fee-only basis.

Confidentiality: NAPFA members shall keep all client data private unless authorization is received from the client to share it. NAPFA members shall treat all documents with care and take care when disposing of them. Relations with clients shall be kept private.

Competence: NAPFA members shall strive to maintain a high level of knowledge and ability. Members shall attain continuing education at least at the minimum level required by NAPFA. Members shall not provide advice in areas where they are not capable.

Fairness & Suitability: Dealings and recommendation with clients will always be in the client's best interests. NAPFA members put their clients first.

Integrity & Honesty: NAPFA members will endeavor to always take the high road and to be ever mindful of the potential for misunderstanding that can accrue in normal human interactions. NAPFA members will be diligent to keep actions and reactions so far above board that a thinking client, or other professional, would not doubt intentions. In all actions, NAPFA members should be mindful that in addition to serving our clients, we are about the business of building a profession and our actions should reflect this.

Regulatory Compliance: NAPFA members will strive to maintain conformity with legal regulations.

Full Disclosure: NAPFA members shall fully describe method of compensation and potential conflicts of interest to clients and also specify the total cost of investments.

Professionalism: NAPFA members shall conduct themselves in a way that would be a credit to NAPFA at all times. NAPFA membership involves integrity, honest treatment of clients, and treating people with respect.

The Difficult Task the SEC Faces After the RAND Report: A Challenge Which Must Be Met Correctly

A White Paper Prepared by the National Association of Personal Financial Advisors

April 15, 2008

Introduction - Recently the Chair of the National Association of Personal Financial Advisors (NAPFA), Tom Orecchio, and a member of its Industry Issues Committee, Ron A. Rhoades, visited with staff of the U.S. Securities and Exchange Commission. For two hours they met with ten members of the SEC staff in a productive meeting to exchange ideas on the future of financial services regulation. The team the U.S. Securities and Exchange Commission (SEC) had put together was highly attentive, cordial, and asked very good questions.

Following that meeting it occurred to Tom and Ron how difficult it must be for any governmental institution to embrace concepts which would, over time, dramatically change the business model of the vast majority of participants in the industry which that government agency regulates. This white paper, prepared by the National Association of Personal Financial Advisors, seeks to address those difficulties.

In this white paper NAPFA summarizes the key distinctions in the means for the delivery of investment advice and products. NAPFA also suggests specific actions which the SEC, and/or the states, could choose to undertake in order to enhance consumer protections.

Arms-Length vs. Fiduciary Relationships

There exist two main types of relationships under the law between the providers of products and services and their customers or clients. In an *arms-length relationship* the buyers and sellers of a product or service act independently and have no relationship to each other. While the buyer must be treated fairly and honestly, no fiduciary relationship is deemed to exist. Often discrete statutory law or regulations impose specific obligations on the seller, such as disclosure of key facts in writing (as seen in consumer credit laws). At other times laws impose specific additional obligations on the seller or seller's agent, such as the duty of suitability imposed upon broker-dealer firms and their registered representatives.

In contrast, *fiduciary relationships* impose upon the seller the highest standard of care under the law. A fiduciary is expected to be extremely loyal to the person to whom they owe the duty, and hence the seller (fiduciary) possesses a "duty of loyalty" to not put his or her personal interests before that of the client. The fiduciary must not profit from his or her position as a fiduciary, unless the principal provides informed consent. The fiduciary duty is often said to consist of three primary duties – loyalty, due care, and utmost good faith. However, other duties (such the duty of "no profit" and the duty to "avoid conflicts") may also exist and may be applied upon the fiduciary.

"Suitability" and other regulations (such as FINRA's regulations which require broker-dealer firms to "observe high standards of commercial honor and just and equitable principles of trade") have elevated, to a small degree, the arms-length relationship above that of where the customer must protect his or her own interests. But the suitability doctrine and other regulations applicable to broker-dealer firms still impose very

few duties, relative to the very high duties imposed upon investment advisers and others in fiduciary relationships.

Three Basic Business Models

While many "hybrid" models exist involving the delivery of investment products and financial and investment advice (which may be part of the confusion of consumers), essentially there are three main business models for the delivery of investment products and/or services:

MODEL 1: DIRECT SALES

Investment Product Manufacturer



Customer

Under this business model the customer chooses to access investment products directly. For example, the consumer may purchase a bond directly from an issuer (such as from the U.S. Treasury), a stock directly from a company (or with the assistance of a discount broker that provides no advice or recommendations), or a no-load mutual fund directly from an investment company.

This business model provides investors the opportunity to reduce intermediation costs substantially. No advice is sought or received by the consumer from the product provider, other than certain required descriptions of the product's characteristics and, in the case of mutual funds, risks the individual investor may face. The product manufacturer may possess a sales representative to aid the purchaser in effecting the transaction or to provide information concerning the product – *i.e.*, a captive "sales agent" or "salesperson."

MODEL 2: PRODUCT SALES

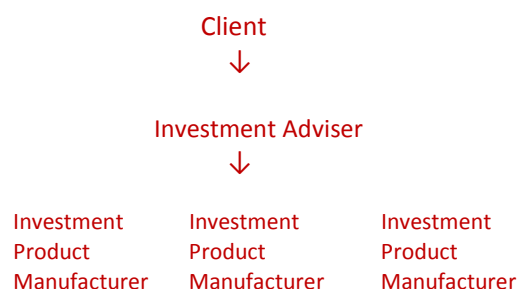


Under this business model the customer deals with a product salesperson. This salesperson represents several, or many, different investment product manufacturers (or issuers of securities). The financial intermediary may also act as a direct seller of an investment product out of its inventory (*i.e.*, acting as a “dealer”) or may act as an agent in effecting the purchase or sale of a security from another firm or its customer (*i.e.*, acting as a “broker”).

The relationship which exists between the customer and the financial intermediary (broker-dealer or its registered representative) is, at its heart, an *arms-length relationship*. While the product sold to the customer must be “suitable”ⁱ for the customer, the suitability concept mainly prohibits the sale of individual products which would possess too much *risk* for that particular customer. Except for certain limits imposed by FINRA regulations concerning the amount of commissions and other fees, the broker-dealer firm is not required to offer lower-cost investment products to the customer. Also, with only one or two exceptions, the broker-dealer firm and its registered representatives are not required to ensure that the investment product is suitable for the customer from the standpoint of its tax efficiency.ⁱⁱ

The obligations of the registered representative revolve around the transaction or the sale of the product or security. There is no requirement that a registered representative possess a reasonable basis to “hold” a security. This is because the suitability obligation to the customer ceases once the transaction is completed. No responsibilities exist to provide either ongoing management of the customer’s portfolio, nor even ongoing advice of a financial nature.

MODEL 3: INVESTMENT ADVISORY



Under this business model the “customer” becomes the “client.” In the diagram above, as a point of emphasis the client is placed first and above that of the investment adviser. This reflects the fact that, in this business model, the investment adviser is engaged to act *on behalf of* the client. The client receives *advice* from the financial intermediary. The advice given must be in the best interests of the client.

In this business model the financial intermediary’s role is entirely different from that of the arms-length relationship of the registered representative. Rather than the consumer being at arms-length with the financial intermediary, the advisor now possesses a *fiduciary relationship* with the client.

Fiduciary duties are imposed upon investment advisers under federal law, deriving from Section 206 of the Investment Advisers Act of 1940.ⁱⁱⁱ The fiduciary duties are not transaction-specific. While the SEC may believe differently (based upon a recent proposed rule), it is clear that fiduciary

duties flow to the entirety of the relationship between the investment adviser and the client, and do not relate just to a specific account or transaction.^{iv}

Regulatory Floor vs. Ceiling - It must further be recognized that the SEC's application of the Advisers Act **sets a floor**, not a ceiling, as to the imposition of fiduciary standards of conduct to the activities of those who promote themselves as "financial consultants" (or similar terms) and to those who actually engage in investment and financial advisory activities. Indeed, many state courts are now applying state common law to find that providers of financial and investment advice owe broad fiduciary duties to their customers, regardless of how they are regulated, since these financial intermediaries are found to be in a position of trust and confidence with respect to the customer.^v

Are fiduciary duties "nebulous"? No more so than the concept of suitability. In a February 27, 2006 speech at the Eighth Annual Investment Adviser Compliance Summit, Lori Richards, Director, Office of Compliance Inspections and Examinations, SEC, provided an overview of an investment advisor's fiduciary obligations:

Understanding "fiduciary duty" is critical, because it is at the core of being a good investment adviser. In a very practical sense, if an adviser and the adviser's employees understand the meaning of fiduciary duty and incorporate this understanding into daily business operations and decision-making, clients should be well served, and the firm should avoid violations and scandal. Indeed, I believe that, even if advisory staff are not aware of specific legal requirements, if their decisions large and small and everyday are motivated and informed by doing what's right by the client, in all likelihood, the decision will be right under the securities laws ...

Some people think "fiduciary" is a vague word that's hard to define, but it's really not difficult to define or to understand ... would suggest that an adviser, as that trustworthy fiduciary, has five major responsibilities when it comes to clients. They are:

1. to put clients' interests first;
2. to act with utmost good faith;

3. to provide full and fair disclosure of all material facts;
4. not to mislead clients; and
5. to expose all conflicts of interest to clients.

These responsibilities overlap in many ways. If an adviser is putting clients' interests first, then the adviser will not mislead clients. And, if the adviser is not misleading clients, then it is providing full and fair disclosure, including disclosure of any conflicts of interest.

How do the responsibilities of a fiduciary translate into an adviser's obligations to clients each and every day? This is a key question. Probably no statute or set of rules could contemplate the variety of factual situations and decisions that an advisory firm faces. Can you imagine the number of rules and releases and regulations that this would require? Instead, the Advisers Act incorporates an adviser's fiduciary duty under Section 206, and envisions that, in whatever factual scenario, the adviser will act in the best interests of his clients.

Principles-Based Regulation - In essence, fiduciary duties, in addition to being the highest standard of conduct imposed by law, represent the ultimate in principles-based regulation. As Ms. Richards suggests, a large number of specific rules would be required to set forth each and every duty, given the number of factual situations in which fiduciary duties are applied. While NAPFA believes further definition of the fiduciary standards of conduct is warranted, such as through the adoption of standards set forth in ISO 22222, or through adoption of the Certified Financial Planner Board of Standards, Inc. revised "Rules of Professional Conduct" (effective July 1, 2008), or through professional ethics rules which a member of NAPFA has proposed,^{vi} the development of more specific standards has been hampered by the fact that arbitration interferes with the development of case law in this area. Moreover, only recently have the investment adviser and financial planning communities achieved prominence in the delivery of investment solutions.

Consumer Confusion: Registered Representatives vs. Investment Advisers

Like other previous studies, the Rand Report (a preliminary draft of which was delivered to the SEC in December 2007, and a copy of which is available on the SEC's web site) revealed that consumers are greatly confused as to the distinctions between registered representatives and investment advisers. In one sense this is surprising, since the duties and roles of the two business models under which these financial intermediaries operate are so distinct. However, this confusion is understandable given the history of federal securities regulation. As stated by the National Association of Personal Financial Advisors in its "Response to the RAND Report"^{vii} NAPFA was "disturbed by the RAND Report's failure to mention the reasons behind the 'blurring of the lines' between broker-dealers and investment advisers. It was recently stated in a comment letter to the SEC from various consumer organizations: "The SEC has over many years steadily undermined the distinction between brokerage and advisory services that Congress recognized and codified, to the point where the distinction no longer bears any relation to the nature of the services provided".^{viii}

A Partial Solution: Greater Disclosure To Consumers of Roles and Duties

In 2004 the Ontario Securities Commission released a concept paper which explored functional delivery of financial services and products. One of the proposals suggested that, for every account opened, the investor and the financial services firm or its representative must sign a document which sets forth the relationship type. Each investor would also be required to be presented with a brief video explaining the choices available to them.

This sounds like an intriguing idea. And it begs the question – what would the form of such a disclosure look like? The disclosure set forth on the following two pages may be appropriate for

this purpose. This disclosure is substantially derived from language first set forth in the Coalition on Investor Education's brochure, *Cutting Through the Confusion*, available at www.nasaa.org.

While the form of disclosure suggested on the two pages following may be helpful to consumers, it still suffers from the inherent limitations of any disclosure. These limitations often render disclosures ineffective as a means of protecting consumers. As explained in a recent comment letter from NAPFA to the SEC:

It has often been said that the federal securities laws' entire focus is on disclosure. NAPFA notes that while enhancing disclosures is always a worthwhile endeavor, there exist inherent limits for disclosure documents – of any size and whatever the content. This is due to behavioral biases which individuals often exhibit in connection with their investment decisions. Such behavioral biases include "bounded rationality," "rational ignorance," insensitivity to the source of information, and the tendency of oral communications to trump written communications.^{ix}

The limitations of disclosures are well-known to broker-dealer firms and others in the financial services industry. Indeed, financial intermediaries utilize their knowledge of investors' behavioral biases in their marketing efforts and personal conferences, often to the detriment of consumers. There are training programs which are designed to train both investment advisers and registered representatives in how to build relationships based upon trust and confidence with consumers. Such training programs often note that once such a relationship is formed that the "consumer will sign anything." No amount of consumer education is likely to substantially counter the behavioral biases underlying this fact. As a result, financial intermediaries will continue to take advantage of the inherent limitations of disclosures.^x

UNDERSTANDING WHO WE ARE. Investment services providers fall into two categories: (1) investment advisers; and (2) brokers. Key differences exist as to the types of services offered, the fees and costs associated with such services, and the different federal and state regulatory requirements and the resulting different legal obligations to their clients or customers. Important distinctions – including whether the provider has a clear obligation to act in your best interests or disclose conflicts of interest – depend on which legal category the provider falls into under our securities laws. *Following is some basic information you can use to find an investment services provider who is right for you – one who offers the services you want on terms you understand and accept.*

Investment Advisers - The term investment adviser is a legal term that describes a broad range of people who are in the business of giving advice about securities (the term “securities” includes stocks, bonds, mutual funds, annuities, and other types of investments). They may use a variety of titles in addition to investment adviser, such as financial planner, financial advisor, financial consultant, investment manager, investment counsel, asset manager, wealth manager, or portfolio manager.

Services Provided. Investment advisers provide ongoing management of investments based on the client’s objectives. The client of an investment adviser may, or may not, give the adviser authority to make investment decisions without having to get prior approval from the client for each transaction (called “discretionary authority”).

Compensation. Most investment advisers charge fees for their services which clients pay directly to the provider. They may be hourly fees or a flat fee or retainer fee for a particular service or range of services. In some instances they may also include a performance fee based on how well the client’s account performs.

Legal Duties to You, the Client. Investment advisers are subject to broad fiduciary duties of due care, loyalty, and utmost good faith to their clients. That means they have to put your best interests ahead of theirs at all times by providing advice and recommending investments that they view as being the best for you. Investment advisers also are required to provide up-front disclosures about their qualifications, what services they provide, how they are compensated, possible conflicts of interest, and whether they have any record of disciplinary actions against them. You should ask for, and receive, a copy of the investment adviser’s disclosure brochure (SEC Form ADV, Part 2, or its equivalent), which contains detailed information about the investment adviser, investment philosophies, fees, conflicts of interest, and how such conflicts of interest are managed to keep your best interests paramount at all time. Investment advisers are regulated directly by the U.S. Securities and Exchange Commission (SEC) or by state securities regulators, depending on the amount of assets they have under management. You can find out whether a person or firm is registered or licensed as an investment adviser by calling your state securities regulator using the contact information on the NASAA website: www.nasaa.org or by visiting: www.adviserinfo.sec.gov.

- **cont. UNDERSTANDING WHO WE ARE.**

Brokers - The terms broker and broker-dealer are legal terms that refer to people who are in the business of buying and selling securities (called trading) for customers. Individual salespeople employed by brokerage firms are often called stockbrokers and are officially referred to as *registered representatives* of the brokerage firm.

Products Provided. Brokers engage in the buying and selling of securities, including stocks, bonds, CDs, mutual funds, annuities, and other types of securities. Brokers sell products, and any investment advice they provide must only be solely incidental to the sale of the product or security.

Compensation. Brokers typically receive their compensation based on commissions clients pay each time they buy or sell a security, and through principal trading (mark-ups and mark-downs on bond prices, selling or purchasing stocks or other securities from or to the broker-dealer firm's own inventory). Other compensation may be paid to a brokerage firm (or, indirectly, to the broker) resulting from the sale of a product, such as 12b-1 fees, soft dollar compensation, bid-ask spreads (including payment for order flow to market makers), and other indirect payments. Commission-based compensation can be an affordable option for customers who expect to trade only rarely, but the payment of commissions and other indirect compensation to brokers by product manufacturers and others may expose customers to potential conflicts of interest, such as creating an incentive to recommend frequent trades or particular investment products.

Legal Duty to Their Customers. Brokers are generally not considered to have a broad fiduciary duty to their customers, although this standard may apply in certain limited circumstances. Instead, brokers are required: to know your financial situation well enough to understand your financial needs, and to recommend investments that are suitable for you (mainly as to risk, as applied to your situation) based on that knowledge. They are not required to provide up-front disclosure of the type provided by investment advisers. In addition to being regulated directly by the SEC and by state securities regulators, brokers are subject to regulation by an industry self-regulatory organization, the Financial Industry Regulatory Authority (FINRA). You can find out whether a person or firm is registered or licensed as a broker and check out their disciplinary record by calling your state securities regulator using the contact information on the NASAA website: www.nasaa.org, or by using FINRA's "BrokerCheck" at www.finra.org.

Date: _____, 20____

Client or Customer Name: _____

I confirm to you that in my relationship with you I am acting as (check one):

____ an investment adviser

____ a broker

_____ (signature)

A More Comprehensive Solution to Consumer Confusion: The SEC Should Apply the Investment Advisers Act More Broadly As Congress Intended

A more comprehensive approach to addressing consumer confusion (and abuse of consumers), which could (and should) be undertaken by the SEC, is to apply the definition of “investment adviser” broadly and the broker-dealer exclusion from such definition narrowly. In essence, the SEC would act in accordance with the express language of the Investment Advisers Act of 1940 and Congressional intent.^{xi}

In a 2007 release for the Proposed Rule, “Interpretive Rule Under the Advisers Act Affecting Broker-Dealers”, the SEC again advanced an interpretation of the “solely incidental” language of the broker-dealer exclusion which is not in accord with the plain meaning of those

words nor Congressional intent. NAPFA suggests a different interpretation of “solely incidental” (see the next page) – one which is in accord with the plain meaning of the term.

Moreover, in that same 2007 release the SEC proposed a “Special Rule” which, if enacted, would tend to increase consumer confusion by permitting a dual registrant (registered representative also licensed as an investment adviser) to act, with respect to the same customer or client, at times subject to a fiduciary duty and at other times not subject to such duties. Needless to say, this “switching of hats” should not be permitted, and NAPFA’s opposition to this Proposed Rule was expressed in previously filed comments with the SEC.^{xii}

PROPOSAL: A DEFINITION OF “SOLELY INCIDENTAL”

1. Under the limited exclusion from the application of the Investment Advisers Act of 1940, broker-dealers and their registered representatives may provide investment advice only when it is *solely incidental* to a securities transaction and only when *no special compensation* is received for such investment advice. “Solely incidental” or “merely incidental” investment advice means only that advice in connection with the sale of a security, such as explaining the fees, costs and characteristics of a security and the risks of the security, so that the investment advice is discrete, minor, casual, and at all times subordinate to the sale process.
2. The following activities are illustrative of forms of advice which are not “solely incidental” to a securities transaction (this is not intended to be an exclusive listing):
 - a. Strategic asset allocation - The division of assets within an investment portfolio with regards to the long term view of the risk and return profile of those asset classes
 - b. Tactical asset allocation - modify their asset allocation according to the valuation of the markets in which they are invested or other valuation or economic factors
 - c. Monitoring an investment portfolio for purposes of advising to switch investments between various securities, or even between sub-accounts of a variable annuity
 - d. Any discretionary authority to effect a trade in a security (even if the discretion only relates to the timing of the trade, and not to the identity of the security)
 - e. Preparing a financial plan addressing the extent, amount, or timing of withdrawals during retirement
 - f. Preparing a financial plan advising as to the amount necessary to accumulate to reach any particular financial goal, such as retirement or educational expenses, or advising as to what type of account (i.e., traditional or Roth IRA or taxable account) to be utilized to effect retirement savings, which is followed by a recommendation or the sale of a security
 - g. Preparing a financial plan which includes any one of more of the following: risk management issues (asset protection planning, whether through insurance or other means), estate planning, and/or tax planning , which is followed by a recommendation or the sale of a security
 - h. Regular or periodic reviews of a client’s investment portfolio, with the goal of determining whether to rebalance the investment portfolio or otherwise address risk levels of the portfolio.
3. Once investment advice has been provided to a client which is subject to the Advisers Act and its imposition of fiduciary duties, further investment advice always remains subject to the Advisers Act and cannot be considered “solely incidental.” Section 215 of the Advisers Act does not permit a client to waive the protections of the broad fiduciary duties of due care, loyalty, and utmost good faith imposed by the Advisers Act.

Opposition to Applying the Advisers Act Broadly: The Dangerous Argument of “Preserving Current Industry Practices”.

Any time one suggests a change to the “status quo” – especially the broader application of fiduciary duties upon nearly all advisory activities – resistance will be substantial. This is despite the fact that there exists substantial support in the law for such an approach, and that the cause of “current industry practices” is a history of decisions by our regulatory institutions which failed to preserve the distinct business models and to keep them separated.

Indeed, a common argument NAPFA members have observed at recent securities industry conferences, and even from various staff of the SEC itself (in published comments), is that the law should be conformed to reflect industry practices. This argument fails intellectual scrutiny. First and foremost, it is not the mission of the SEC to preserve the business practices of broker-dealer firms. Rather, it is the SEC’s mission to protect consumers and preserve our capital markets system. Second, a “preservation of current industry practices” has long been known to be a root evil that has caused previous scandals in the securities industry and investor harm. As stated in a speech by Stephen M. Cutler, Director, Division of Enforcement, SEC:

The disconnect between the views of Wall Street insiders and public investors is instructive and holds important lessons. First, it illustrates vividly that just because a certain way of doing things is second nature to you, and appears to be standard operating procedure on the Street, doesn't mean it's the correct way of doing things. Second, it suggests that when your customers finally do come to understand certain industry practices, they will care a great deal about undisclosed conflicts of interest. And as you have witnessed, when conflicts are exposed, the costs to the

industry are enormous - in dollars, in reputation, and in investor confidence and trust.^{xiii}

It is well known that consumers are confused – and often abused – when they receive advice from those holding themselves out (through advertisements and the use of titles) as trusted advisors, when in fact such “advisors” do not believe themselves to be bound by fiduciary standards of conduct. The sale of expensive, tax-inefficient products by “financial consultants” (registered representatives and insurance agents) to unsuspecting consumers has reached alarming levels.

What is less obvious is that many consumers, victims of such abuse, have departed from participation in our capital markets. To their own detriment, and the detriment of the U.S. economy, they only feel safe investing in certificates of deposit and savings accounts, and have no desire to ever invest again in stocks, bonds, or mutual funds. NAPFA members have personally observed this in their discussions with potential clients to their firms. Indeed, the loss of trust in financial advisors and its attendant ramifications is also known in the academic literature, for as stated by Professor Tamar Frankel:

I doubt whether investors will commit their valuable attention and time to judge the difference between honest and dishonest ... financial intermediaries. I doubt whether investors will rely on advisors to make the distinction, once investors lose their trust in the market intermediaries. From the investor’s point of view, it is more efficient to withdraw their savings from the market.^{xiv}

Hence, the notion that the law should conform itself to industry practices remains an inherently dangerous concept. Rather than seek to modify (or continue to not apply) the law which imposes fiduciary duties upon investment advisory

activities, the SEC should change course and act in the public interest – to apply the law, and the consumer protections afforded by imposition of fiduciary duties – as Congress intended.

Powerful Economic Forces Are Opposed to Disintermediation.

NAPFA members are not so naïve, nor idealistic, to fail to understand that the fiduciary business model of the investment advisor, if applied broadly and comprehensively as Congress intended, will effect major disruptions in our securities industry. Indeed, NAPFA has always favored transitional rules, which will be necessary to afford financial intermediaries time to adjust to the new realities, if and when regulators more fully embrace the benefits of fiduciary standards of conduct.

Major economic forces oppose imposition of fiduciary duties upon those intermediaries providing investment advice. Why is this so? As broker-dealer firms have been told by their consultants, the fiduciary business model is far less profitable than the arms-length product sales model. This is because, under the fiduciary business model, the investment adviser acts as a “purchaser’s representative” on behalf of the client. Since fees and costs directly and negatively impact, on average, the returns received by individual investors (much academic research has shown this), the investment adviser has a duty to keep reasonable the “total fees and costs” (including “hidden costs”) ^{xv} paid by the client in connection with the receipt of investment and financial advice and the purchase of investment products. This results in a close examination of the often-hidden fees and costs of many pooled income products, and results in downward pressures on fees. As a result, disintermediation occurs.

Disintermediation can be defined as the reduction or elimination of the role of retailers, distributors, brokers, and other middlemen in transactions between the producer and the customer. In the present context, this is the replacement of one high-cost (to consumers) and high-profit (for broker-dealer firms) business model with the lower-cost model which involves investment advisers. When disintermediation such as this is threatened to occur upon the actors in an industry, those within the industry which are threatened by it do not just sit idly by. Instead, they use all of the judicial, regulatory, and legislative means at their disposal to thwart competitors who offer a more efficient (and/or higher-quality) means for delivery of the product or service. In a sense, efforts to counter disintermediation reflect one of Sir Isaac Newton’s laws of physics - for every action there is an equal and opposite reaction. Indeed, the recent few decades have witnessed concerted efforts to not apply the Investment Advisors Act of 1940, and its enhanced protections for consumers and the resulting lower profits for the securities industry. The failed fee-based brokerage accounts rule was perhaps the most dramatic attempt to counter disintermediation, but there have been many others, some of which remain in the SEC’s current interpretations of the scope of application of the Investment Advisors Act of 1940.

The question the SEC faces is whether it will continue its current course of action – to be used by the forces opposed to disintermediation – or whether it will change course and embrace fiduciary duties. It will take the courage of SEC’s leadership and staff to resist the substantial pressures from those forces which oppose imposition of fiduciary duties and preservation of the *status quo* (to the detriment of consumers and to preserve their profits).

Why Are Fiduciary Duties So Important To Consumers?

The SEC must not only inquire as to what fiduciary duties are all about, but must also ask why fiduciary duties are so important.

It is widely acknowledged that there exists a significant gap between the knowledge of financial intermediaries and the vast majority of investment consumers today. This gap is made even wider by a proliferation both in types and numbers of investment products. The RAND Report notes that disclosures are inadequate as a means of addressing this gap:

Financial service providers present the required disclosures but do not take time to explain them. Many participants also mentioned that many investors do not take the necessary time and effort to fully read and understand disclosures.^{xvi}

One (registered representative) interviewed by Rand acknowledged that a client is going to sign something that a trusted adviser asks them to sign. Clients feel that the reason they engage a professional is so that they do not have to read all the accompanying literature. Therefore, for many investors, the fact that they were given disclosures was seen as meaningless.^{xvii}

The RAND Report also noted that both registered representatives and investment advisers “acknowledged that their business relationships with clients are built on trust rather than investor understanding of the services and responsibilities involved and that it is crucial for the financial service industry to maintain that foundation of trust.” (RAND Report at pp. 131-2) In relationships based on trust and confidence, especially where superior knowledge is present, fiduciary duties serve to protect the interests of the client. As explained in an academic article examining fiduciary law:

[T]he justification for fiduciary duties is clear. When one person is authorized to act on behalf of another and to exercise discretion over critical

resources belonging to the other, a duty of loyalty helps to align incentives ... As noted by Robert Cooter and Bradley Freedman, ‘Once a consensual relationship in which the principal relinquishes control or management of her asset to the agent is formed, the resulting separation of ownership from control or management creates opportunities for the agent to appropriate the asset or some of its value. Taking advantage of these opportunities whether by theft, diversion, conversion, or trespass would violate the agent’s duty of loyalty.’^{xviii}

Fiduciary duties are imposed by law. And, when they are imposed to affect public policy, such as continued trust by consumers in our capital markets system, fiduciary duties cannot be waived.

We must recognize that the world is far more complex for individual investors today than it was just a generation ago. A broad variety of investment products exists, including many types of pooled and/or hybrid products, employing a broad range of investment strategies. This explosion of products has hampered the ability of individual investors to sort through the many thousands of investment products to find those very few which best fit within the investor’s portfolios.

Furthermore, as the many different types and numbers of investment vehicles proliferate, investors are challenged to discern an investment product’s true “total” fees and costs. This is seen in the Rand Report, which found that over thirty percent (75 of 246) consumers who responded to the Rand survey indicated that they paid nothing for investment advisory services or for brokerage services!^{xix} Additionally, U.S. tax laws have increasingly become more complex, presenting opportunities for the wise through proper planning and traps for the unwary.

As the sophistication of our capital markets, as well as portfolio construction and portfolio management methodology, have increased, so

has the knowledge gap between individual consumers and knowledgeable financial advisors. Investment theory continues to evolve, with new insights gained from academic research each year. In constructing an investment portfolio today a financial advisor must take into account not only the individual investor's risk tolerance and investment time horizon, but also the investor's tax situation (present and future) and risks to which the investor is exposed in other aspects of his or her life.

Clients in receipt of investment advisory services will nearly always start off, in their discussions with their investment advisors, from a position of contractual weakness and in reference to the complexities of portfolio construction and an understanding of investment products, from a position of relative ignorance. Such lack of knowledge results in the consumer being unable to protect him or herself from the action of the expert advisor without significant agency costs (such as might arise from the engagement of a second expert to monitor the activities of the first expert). The fiduciary duty to act in the best interests of another is thereby imposed by the law upon the party with the greater knowledge and expertise in recognition by the law that the client is in need of protection and care and as a means of reducing agency costs.

The fact is that we should not expect the vast majority of individual consumers to be able to successfully navigate today's complex financial world anymore than we would expect them to act as their own attorney or physician.

The Importance of the Proper Application of Fiduciary Duties to the Investment Advisory Profession

While fiduciary duties are primarily designed for the protection of consumers, their *consistent* application to the same functional activities is also highly important to investment advisers and personal financial advisors. As explained in the recent decision of *Financial Planning Association vs. SEC*, 482 F.3d 481 (D.C. Cir., 2007):

Just as the text and structure of paragraph of 202(a)(11) make it evident that Congress intended to define 'investment adviser' broadly and create only a precise exemption for broker dealers, so does a consideration of the problems Congress sought to address in enacting the IAA. A comprehensive study conducted by the SEC pursuant to the Public Utility Holding Company Act of 1935 indicated that "many investment counsel have 'strayed a great distance from that professed function' of furnishing disinterested, personalized, continuous supervision of investments." Securities and Exchange Commission, Investment Counsel, Investment Management, Investment Supervisory and Investment Advisory Services, at 25 (1939) (quoting testimony of brokerage executive James N. White, of Scudder, Stevens & Clark). Floor debate on the IAA called attention to the fact that while this study was being conducted investment trusts and investment companies had perpetrated 'some of the most flagrant abuses and grossest violations of fiduciary duty to investors.' 86 Cong. Rec. 2844 (daily ed. Mar. 14, 1940) (statement of Sen. Wagner). Congress reiterated throughout its proceedings an intention to protect investors and bona fide investment advisers ...

The IAA's essential purpose was to "protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard the honest investment adviser against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful." H.R. Rep. No. 76-2639 at 28.

Stated differently, fiduciary investment advisers desire prestige, and they do not desire “hucksters” and “tipsters” to belong to, or be associated with, their profession.

The economic argument for consistent application of fiduciary standards of conduct is a powerful one. Should a regulatory body permit others to undertake substantially the same services as those provided by the fiduciary without imposition of fiduciary status, it hinders the marketability of the fiduciary. Professor Macey in his 2002 article, *Regulation of Financial Planners*, observed:

Each financial planner has incentive to develop and maintain a reputation for honesty and competence in order to increase the demand for his services. All financial planners suffer when the reputation of the profession suffers because consumers are unable to distinguish between high-quality services of ethical or competent financial planners and low-quality services of unethical or incompetent financial planners. This, in turn, reduces the market's demand and willingness to pay for financial planners. The practical implications of this basic problem, described by economists as ‘information asymmetry’ because of the fact that consumers have less information than producers (and therefore the distribution of information between the sellers of services and the buyers of services is asymmetric) are important for the future of any industry or profession.

The general problem was first described in a famous article by George Akerloff, in which he showed what would happen to an industry if consumers were unable to distinguish between high quality producers and low quality producers [citing George A. Akerlof, *The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970)]. The consequences of this problem are far more severe than may appear at first blush. The structure of the problem can be described with reference to the financial planning profession as follows: suppose, for the sake of clarity and simplicity, there are only three types of financial planners, excellent quality planners, whose work is worth \$900 per hour, medium quality financial planners, whose work is worth \$300 per hour, and low quality financial planners, whose work is worth minus \$300 per hour because of the costs that such planners impose on their clients through incompetence and fraud. Imagine

further that consumers are unable to differentiate among these various types of financial planners until after they have received their services. They don't know whether the advice they are getting is of high, medium or low quality until they have purchased the advice. Where this is true, economists have shown that the products all will sell for the same price, because consumers who pay more than the standard market price still will be unable to increase the probability that they are receiving high quality advice.^{xx}

It is submitted that financial planning was always performed by investment counselors (now called investment advisers); certain aspects of the legislative history of the Investment Advisers Act of 1940 even noted the “planning” activities of investment counsel.

Regardless of whether financial planners are a subset of investment advisers (or *vice versa*), it must be recognized that, from an economic perspective, a profession of fiduciary actors is granted a monopoly. Through ensuring adherence by its members with their fiduciary duties, the prestige of all members of the profession is enhanced. This in turn creates greater demand for the profession's services. If, however, others can provide the same functional services, or use the same or similar titles, and not be subject to the same high fiduciary standards of conduct, the improprieties of these non-fiduciary actors will diminish the profession's image, as well.

The price of this monopoly (one granted to the profession, not to its individual members) is the giving up of something – the opportunity to utilize superior knowledge of investments and the capital markets to take advantage of the client. Substantial profit opportunities are removed; instead rules of professional conduct are imposed which limit the actions of the fiduciary advisor. One such rule is that the compensation paid to the investment adviser must be reasonable. In essence, adherence to the fiduciary duties of due care, loyalty, and utmost good faith is the price

the investment adviser pays for the ability to practice as such.

Please note that NAPFA does not suggest that investment advisers seek a competitive advantage over registered representatives. That competitive advantage already exists – anytime NAPFA members hold themselves out as a “fiduciary” to a prospective client, and point out that a registered representative competing for the same business does not possess the legal duty to act in the best interests of the same prospective client – they possess a marketing advantage and a greater ability to secure the client.

The desire of NAPFA members for greater application by the SEC of fiduciary standards of conduct is, therefore, not a self-serving one. Indeed, should the SEC more fully and correctly apply fiduciary standards of conduct to all financial advisory activities, there will be a continued expansion of the number of investment advisers. The competitive position of individual current investment advisers will be diminished, not enhanced. Indeed, this has already been seen, as the *Financial Planning Association vs. SEC* decision of 2007 led to a great many registered representatives obtaining licensure as investment adviser (representatives), thereby creating more competition among investment advisors.

Representatives of broker-dealer firms sometimes argue that their “robust” FINRA regulation and enforcement is superior to that of investment advisers. Admittedly the number of inspections of some investment advisers is less frequent than that of broker-dealer firms, and there are also other differences in the inspection and enforcement regime. However, the risk to investors posed by investment advisers is much less, as the number of conflicts of interest between the financial intermediary and the consumer is dramatically reduced. Indeed, one

professional liability insurance underwriter noted that both the quantity and size of claims against investment advisers was significantly below that of registered representatives.

Moreover, even if there is some truth in the assertion that investment adviser regulation is less robust, the remedy the representatives of broker-dealer firms seek to apply does not make sense. They suggest that fiduciary standards of conduct not be applied, and instead that lower standards of suitability be applied to all financial intermediaries. They suggest a “rush to the bottom,” not a “rush to the top.” Rather than fix any discrepancies which may exist in the investment adviser inspection and enforcement regime (and there are multiple ways to do this), the broker-dealer industry representatives appear to suggest a complete abandonment of the investment adviser regulatory scheme, its higher standards of conduct, and its greater protections for investors. The reasoning of these broker-dealer industry representatives is both flawed and self-serving.

What Is At Stake? Just America’s Economic Future

Proper financial planning is essential to encourage both an increase in household savings and in order to invest those funds more effectively. Proper investment decision-making is crucial, and most of our fellow citizens will require expert advice to keep fees and costs reasonable, to minimize risks which are not adequately compensated, to manage emotional biases of individual investors which so often lead to detrimental activities such as “chasing returns,” and to reduce the tax drag on investment returns.

If people do not make careful, rational decisions about how to provide for their financial security over the course of their lifetimes, then the

government will have to step in to save people from the consequences of their poor planning.

In Conclusion – It Is Time

The issue confronting the SEC – what policy recommendations to pursue following its examination of the Rand Report and discussions with industry representatives – is an important one. We may well be at the crossroads of securities regulation in America, where we change course to embrace, or at least not deter, the fiduciary business model. Or we may yet again see the SEC act as the unwitting agent of forces opposing disintermediation, to the detriment of consumers and continuing down a course which poses additional economic threats to America's future.

NAPFA remains hopeful that the SEC – or state regulators – will acknowledge that Americans are suffering and need *objective* advice to navigate today's complex financial world. As stated in a recent academic paper:

Empirical studies of actual investor behavior – studies conducted mostly by finance professors – find that fund investors generally are unknowledgeable, lack financial sophistication, and suffer from numerous cognitive biases. These studies find that most fund investors are unaware of the investment objectives, composition, and risks of their funds. Most investors are also ignorant of the level of fees and expenses charged by their funds, and these costs are not a significant factor in their fund choices. Also, most fund investors chase past performance, despite significant evidence that past returns generally do not predict future returns.^{xxi}

The time has come for fiduciary duties to be applied broadly by our securities regulators to the provision of investment advice and to the provision of financial planning services. It is also important to preserve the fiduciary standard of conduct, and to not permit either its application or its enforcement to be eroded by particular exceptions.^{xxii} The use of misleading titles, evoking relationships of trust and confidence, when in fact none exist (or at least are denied to exist), must be prohibited.

It is also time for our industry organizations and/or their members to come together to advance personal financial advisors as a true profession. National and well-defined standards of conduct must be embraced. Peer review, essential for proper enforcement of fiduciary duties, must be added to the regulators' arsenal of inspection and enforcement regimes.

It is time to abandon the *status quo* and the inconsistent application of fiduciary standards of conduct. Rather, it is time to embrace the reality of the modern, complex financial world. It is time to apply broad fiduciary duties of due care, loyalty and utmost good faith upon all providers of investment and financial advice, for the benefit of us all.

- The National Association of Personal Financial Advisors

April 15, 2008

ⁱ The primary suitability rule of the brokerage business is NASD Rule 2310 - Recommendations to Customers, which provides:

(a) "In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

(b) "Prior to the execution of a transaction recommended to a non-institutional customer, other than transactions with customers where investments are limited to money market mutual funds, a member shall make reasonable efforts to obtain information concerning

(1) the customer's financial status;

(2) the customer's tax status;

(3) the customer's investment objectives; and

(4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer."

ⁱⁱ As part of the suitability analysis under Rule 2310 regarding a recommendation to sell a deferred variable annuity, a registered representative must consider, inter alia, tax consequences, surrender charges and loss of benefits (such as death, living or other contractual benefits).

ⁱⁱⁱ It was known by the SEC that the Investment Advisers Act of 1940 imposed fiduciary status upon investment advisers well before the U.S. Supreme Court's 1963 decision in SEC vs. Capital Gains Research Bureau. In Release No. 40-40 (Jan. 5, 1945), Fed. Sec. L. Rep. (CCH) para. 56,374, the SEC noted that "[a]n investment adviser is a fiduciary. As such he is required by the common law to serve the interest of his client with undivided loyalty ... [A] breach of this duty may constitute a fraud within the meaning of clauses (1) and (2) of Section 206 of the Investment Adviser Act (as well as the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934)."

^{iv} The National Association of Personal Financial Advisors (NAPFA) and Ron A. Rhoades, individually, filed comments (dated November 2, 2007) expressing their opposition to the "Special Rule" set forth in the SEC's Proposed Rule of September 24, 2007 ("Interpretive Rule Under the Advisers Act Affecting Broker-Dealers," File No.: S7-22-07). These commentators assert that once an investment adviser assumes the "fiduciary hat" with respect to a client, federal law does not permit that hat to be removed with respect to that client, nor should public policy permit "bait and switch" tactics. The reasoning for the proposition that fiduciary duties attach to the whole of a relationship, and that once assumed they cannot be waived, is set forth in those comment letters, copies of which are available on the FiduciaryNow.com web site. As of the date of this writing the SEC has not finalized the Proposed Rule. If finalized in its present form, some suspect the rule will be judicially challenged.

^v See Rhoades, "State Common Law Applying Fiduciary Duties Upon Financial Advisors," available at the web site FiduciaryNow.com, under the site's "State Law" section, noting that "while most issues involving the application of common law fiduciary duties to the activities of financial intermediaries serving individual investors are not made public due to the confines of mandatory arbitration, some cases do emerge ... state courts increasingly apply broad fiduciary duties to financial advisory relationships."

^{vi} See Rhoades, "What Are The Specific Fiduciary Duties?" – available at FiduciaryNow.com, under "Proposals."

^{vii} NAPFA's "Response" is dated January 9, 2008, and is available at www.NAPFA.org, under "Press Room" and then under "Comments on Industry Issues."

^{viii} NAPFA's "Response", citing a comment letter dated February 7, 2005, from Fund Democracy, Consumer Federation of America, Consumers Union, and Consumer Act, re: SEC proposed rule, "Certain Broker-Dealers Deemed Not To Be Investment Advisers."

^{ix} NAPFA comment letter dated February 28, 2008, regarding “Summary Prospectus” SEC proposed rule, available at www.NAPFA.org, under “Press Room” and then under “Comments on Industry Issues.”

^x “[N]ot only can marketers who are familiar with behavioral research manipulate consumers by taking advantage of weaknesses in human cognition, but competitive pressures almost guarantee that they will do so.” Robert Prentice, “Contract-Based Defenses In Securities Fraud Litigation: A Behavioral Analysis,” 2003 U.Ill.L.Rev. 337, 343-4 (2003), citing Jon D. Hanson & Douglas A. Kysar, “Taking Behavioralism Seriously: The Problem of Market Manipulation,” 74 N.Y.U. L. REV. 630 (1999) and citing Jon D. Hanson & Douglas A. Kysar, “Taking Behavioralism Seriously: Some Evidence of Market Manipulation,” 112 Harv. L. Rev. 1420 (1999). Given potential use of behavioral biases by financial intermediaries, should there be attempts to educate individual consumers on how to counter these biases? “The ... direction – inviting a role that securities regulation has never taken that seriously – is to become an aggressive therapist, seeking to de-bias investors from all their dangerous propensities ... I doubt that the government could do this well, or that the intended audience would have the inclination to learn.” Donald Langevoort, “Taming the Animal Spirits of the Stock Market: A Behavioral Approach to Securities Regulation,” Paper 64, Berkeley Program in Law & Economics, Working Paper Series (2002). See also Robert Prentice, Professor of Law, University of Texas at Austin, “Whither Securities Regulation? Some Behavioral Observations Regarding Proposals For Its Future,” 51 Duke L. J. 1397 (2002), stating: that there exists a “large body of behavioral evidence indicating that investors, even sophisticated institutional investors, are unlikely to protect themselves adequately.” *Id.* at 1510. See also “Final Report on Financial Planner Standards of Conduct,” prepared by the FPA® Fiduciary Task Force, dated June 1, 2007, stating at page 39: “Recent scholarship in behavioral law and economics reveals that behavioral biases substantially inhibit the ability of many individual investors to achieve sufficient knowledge through a disclosure regime. An extensive discussion of these behavioral biases is found in the January 26, 2007 memorandum of Ron A. Rhoades, Esq., ‘Lessons From Behavioral Science: The Effectiveness Of Disclosures Provided to Clients of Financial Intermediaries,’ set forth as Appendix F.

^{xi} The U.S. Court of Appeals decision in *Financial Planning Association vs. SEC*, No. 04-1242 (D.C. Cir., March 30, 2007), possesses potentially far-reaching implications. Three times in that decision the Court emphasized that the term “investment adviser” was “broadly defined” by Congress. Additionally, in discussing the exclusion for brokers (insofar as their advice is solely incidental to brokerage transactions for which they receive no special compensation), the U.S. Court of Appeals stated:

“The relevant language in the committee reports suggests that Congress deliberately drafted the exemption in subsection (C) to apply as written. Those reports stated that ‘investment adviser’ is so defined as specifically to exclude ... brokers (insofar as their advice is merely incidental to brokerage transactions for which they receive only **brokerage commissions**)” [Emphasis added.]

As a result of this language, all arrangements in which broker-dealer firms and their registered representatives receive compensation other than commission-based compensation should be reviewed to see if the definition of “investment adviser” found in 15 U.S.C. §80b-2.(a)(11) applies:

“Investment adviser” means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities

For example, the issue has recently been raised as to whether the receipt of 12b-1 fees by broker-dealer firms and their registered representatives, which by the SEC’s own admission are asset-based fees and relationship compensation, run afoul of the IAA when received by those outside investment advisory relationships with their customers. The written statements of many brokerage industry representatives acknowledge that 12b-1 fees are utilized in large part to compensate registered representatives (RRs) for the fostering of an ongoing relationship between the RR and the investor, including the provision of advice over time with respect to a customer’s personal circumstances, and including financial planning, estate planning, and investment advice (not specific to any transaction).

While industry representatives have argued that the 12b-1 fee “compensation” received by the broker-dealer firm is not paid by the customer directly, there is no qualification in the definition of investment adviser which says that compensation must be directly paid by an investor. Moreover, there is a common law principle which attorneys were taught when they were in law school: “You cannot do indirectly what you cannot do directly.” In other words, “if it walks like a duck....” While admittedly Class C shares in particular, and fee-based compensation in general, better align the interests of investors with those of financial intermediaries, such an alignment is not the basis of any exclusion from the application of the IAA. Given the significance of this issue, all ongoing payments to advice-providers deserve close scrutiny.

^{xii} Comment letter of the National Association of Personal Financial Advisors (NAPFA), dated November 2, 2007, available at www.NAPFA.org, under “Press Room” then under “Comments on Industry Issues.” See also comment letter of Ron A. Rhoades, dated November 2, 2007, available at www.FiduciaryNow.com, under “Federal Law” heading.

^{xiii} Remarks Before The National Regulatory Services Investment Adviser and Broker-Dealer Compliance/Risk Management Conference, by Stephen M. Cutler, Director, Division of Enforcement, U.S. Securities & Exchange Commission, Charleston, South Carolina, September 9, 2003.

^{xiv} Professor Tamar Frankel, “Regulation and Investors’ Trust In The Securities Markets,” 68 Brook. L. Rev. 439, 448 (2002).

^{xv} “These ‘hidden costs’ of fund investing (as they are not included in the fund’s portfolio turnover rate), include brokerage commissions, principal trade mark-ups and mark-downs, market impact, bid-ask spreads, and opportunity costs due to delayed or canceled trades.” NAPFA Comment Letter to SEC dated Feb., 28, 2008 re: Summary Prospectus.

^{xvi} RAND (Preliminary) Report at p.21.

^{xvii} RAND Report at p.86.

^{xviii} D. Gordon Smith, “The Critical Resource Theory of Fiduciary Duty,” 55 Vanderbilt L. Rev. 1399 (2002), at p.1497.

^{xix} Rand Report at p.108.

^{xx} “Regulation of Financial Planners,” White Paper Prepared for the Financial Planning Association by Jonathan R. Macey, April 2002, available at <http://www.fpanet.org>, under “Government Relations” / “White Papers.”

^{xxi} Alan Palmiter, Professor of Law, and Ahmed Taha, Associate Professor of Law, “Mutual Fund Investors: Divergent Profiles,” Wake Forest Legal Studies, Research Paper Series, SSRN Research Paper No. 1098991 (February 2008).

^{xxii} In any efforts dedicated to the process of these reforms, the highest standard under the law – that of the fiduciary – must be preserved. Chief Judge Cardozo of the Court of Appeals of the State of New York, in an often quoted passage from his opinion in *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546 (1928), described a fiduciary’s duty of loyalty as follows: “Many forms of conduct permissible in a workaday world for those acting at arm’s-length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the ‘disintegrating erosion’ of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.”