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Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE Washington, DC 20549-1090
VIA ELECTRONIC MAIL: rule-comments@sec.gov

Re: Release No. IA-4889; File No. S7-09-18

Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation

Dear Mr. Fields:

We are responding to the request of the Securities and Exchange Commission (the "Commission") for comments about the proposed interpretation of the standard of conduct for investment advisers under the Investment Advisers Act of 1940 (the "Advisers Act"). We recognize the time and effort invested by the Commission and the Staff of the Division of Investment Management (the "Staff") in formulating the proposed interpretation and appreciate the opportunity to comment.

Stark & Stark, PC is a law firm, with offices in New Jersey, New York, and Pennsylvania. Our clients include, among others, investment advisers registered with the Commission that provide services to retail clients that may be affected by the proposed interpretation. These comments, while informed by our experience in representing these clients and our discussions with several clients, represent our own views and are not intended to reflect the views of any of the firm's clients.

We applaud the Commission's effort to make sure that investors are aware of the differences between investment advisers and broker-dealers. We also applaud the Commission's efforts for providing its interpretation of the boundaries arising from the fiduciary duty owed by investment advisers to their clients. While we respectfully disagree with certain of the Commission's interpretation of the duty of care as further discussed below, we acknowledge that it likely possesses the authority to address these issues under its rulemaking authority contained in Section 206(4) of the Advisers Act. Notwithstanding, we believe that interpretations of the fiduciary duty owed by investment advisers should remain grounded in common law principles.

In addition, we are submitting this comment letter to respond to certain of the requests for comment posed by the Commission.

I. The Commission's Interpretation of the Duty of Care Will Lead to Unnecessary Confusion

We believe that the Commission's proposal to include the "the duty to act and to provide advice that is in the best interest of the client" as a subset of the duty of care is unnecessary, overly restrictive and will complicate nearly a century of settled jurisprudence on the issue. It also would require expansive new guidance from the Commission and the Staff in determining precisely which activities fall under each of the duty of care and loyalty. In short, we believe the duty to provide advice in the best interest of the client should continue to be viewed under the duty of loyalty.

The concept of fraud in Section 206(1) and (2) of the Advisers Act has historically been based on common law principles[1] and includes the duty of loyalty. The duty of loyalty refers to the obligation to act loyally for the client's benefit, which requires that the adviser place the client's interests ahead of its own.[2] The duty of loyalty has historically required the disclosure of all material facts between an investment adviser and its clients.[3] The Commissions recent cases and initiative requiring disclosure of an investment adviser's or its affiliate's receipt of Rule 12b-1 fee compensation appear to be grounded in the duty of loyalty, which seem to suggest that disclosure alone could have cured the conflict of interest.[4]

The Commission's proposal seeks to apply the duty of care to the rendering of all actions and advice rendered by an investment adviser and appears to limit an investment adviser's ability to disclose away conflicts of interest relating to its advice. This might suggest that an investment adviser focused exclusively on asset management might have to become a financial planner and examine whether a discussion with a prospective client to "hire me" would truly be in the client's best interest.

The proposed interpretation also suggests that advice about whether to rollover a retirement account that results in the investment adviser managing that account falls under the duty of care as opposed to the duty of loyalty. This appears to create an affirmative obligation that is not subject to waiver or disclosure for an investment adviser to conduct due diligence on the client's fees and

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[1] *See, e.g., In re Brandt, Kelly & Simmons, LLC & Kenneth G. Brandt*, SEC Administrative Proceeding File No. 3-11672 (Sept. 21, 2004) (alleging that respondent "willfully violated Sections 206(1) and 206(2) of the Advisers Act, *which incorporate common law principles of fiduciary duties*" (emphasis added)).

[2] *See* Restatement (Third) of Agency § 8.01 (2006) ("An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship."); § 8.01, cmt. b ("Although an agent's interests are often concurrent with those of the principal, the general fiduciary principle requires that the agent subordinate the agent's interest to those of the principal and place the principal's interests first as to matters connected with the agency relationship."); *see also* Restatement (Third) of Trusts § 78(1) (2007) ("Except as otherwise provided in the terms of the trust, a trustee has a duty to administer the trust solely in the interest of the beneficiaries, or solely in furtherance of its charitable purposes.")

[3] *See* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963) ("SEC v. Capital Gains").

[4] *See, e.g.,*, Credit Suisse Securities USA (LLC), Investment Advisers Act Rel. No. 4678, 2017 SEC LEXIS 1033 (Apr. 4, 2017); Cadaret, Grant & Co., Inc, Investment Advisers Act Rel. No. 4736, 2017 SEC LEXIS 2308 (Aug. 1, 2017); Envoy Advisory, Inc., Investment Advisers Act Rel. No. 4764, 2017 SEC LEXIS 2780 (Sept. 8, 2017); and SunTrust Investment Services, Inc., Investment Advisers Act Rel. No. 4769, 2017 SEC LEXIS 2844 (Sept. 14, 2017).

expenses and current management. We disagree with this characterization and result even though it seems to track the intent of the recently rescinded Department of Labor's Fiduciary Rule.[5]

The recommendation of whether to hire an investment adviser or entrust them with additional assets for management is wholly removed from the investment process and differs from an investment adviser's duty to seek best execution or monitor a client's assets. The duty of best execution and duty to monitor a client's assets address an aspect of an investment adviser's management and stewardship of a client's assets. Treating an investment adviser's recommendation to a client to entrust them with additional assets under a "best interest" standard would be akin to suggesting that a doctor must recommend a more experienced or more skilled doctor, even though they believe that they are themselves qualified to handle a procedure. The duty of care at common law and under the Advisers Act only requires that advisers not be negligent in performing their duties.[6] Therefore, seeking to accumulate new clients and assets should logically be placed under the duty of loyalty and subject to a disclosure regime where clients can be notified about the conflict of interest and provide their informed consent to these recommendations.

Should the Commission disagree, we would request that the Commission provide more guidance so that investment advisers can comply with the Commission's intent. For example, the Commission would need to provide clarity on the requisite level of due diligence required before an investment adviser charges fees for managing a client's retirement assets or recommending a rollover.

II. Response to the Commission's Request for Comment

In addition, we wanted to take this opportunity to respond to certain of the requests for comment posed by the Commission. While all of the requests of the Commission deserve considerable attention and debate, we wanted to focus specifically on those concerning federal licensing and continuing education, the provision of account statements and financial responsibility.

a. Federal Licensing and Continuing Education

We believe that the current state licensing standards applicable to Commission-registered investment advisers and their "investment adviser representatives" as defined under Section 202(a)(25) strikes the appropriate balance of requiring licensing for those individuals who appear to be in the business of rendering investment advice to retail clients.[7] Anecdotally, we find that these individuals have the most interactions with retail investors and pose the greatest potential risk of harm to this subset of investors. The current state licensing requirements and waiver of the prerequisite to take and pass the Series 65 examination or equivalent is sufficiently uniform in most, if not all, states.

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[5] See, e.g., 81 Fed. Reg. 21002 (April 8, 2016) (proposing the Best Interest Contract Exemption).
[6] Tamar Frankel, Arthur Laby & Ann Schwing, The Regulation of Money Managers, (updated 2017).
[7] *See* Advisers Act Section 203A(b)(1). See also, Advisers Act Rule 203A-3.

We do believe that there are aspects of the licensing process that can be improved. We believe that the re-examination requirements imposed on investment adviser representatives is unnecessarily burdensome without providing a correlating benefit. For example, most states impose a re-examination requirement if an investment adviser representative experiences a two-year hiatus in licensing and employment. For mothers and fathers and military personnel re-entering the workforce this creates an unnecessary bar to employment. We believe that the Commission should consider preempting this impediment to employment entirely or alternatively extend the gap in licensing to a five-year hiatus that would require reexamination. To our knowledge, the examination does not frequently change and investment professionals could easily familiarize themselves with changes in the law and profession upon their reentry into the workforce.

We would also appreciate it if the Commission would provide additional interpretation by confirming that solicitors operating under Rule 206(4)-3 can be considered to be "supervised persons" within the meaning of Section 202(a)(25) and may be "subject to the supervision and control" of an investment adviser. Ideally, the Commission would provide clear standards of what the requisite level of supervision and control is required for solicitors. Many solicitors who do nothing more than introduce clients to investment advisers currently operate in a gray area due to their hesitancy in relying on the definition of "supervised person" found in Section 202(a)(25). This results in many solicitors unnecessarily registering with state securities commissions and subjecting them to examination in many states.

We generally believe that the current licensing standards are sufficiently crystallized and provide administrative, operational and legal clarity for Commission-registered investment advisers and their legal and compliance professionals. While changes could be made to marginally protect retail investors, it could potentially place an immense burden on the industry by upsetting years of clarity. We believe that the burden outweighs the benefit in this instance.

b. Provision of Account Statements

In response to the Commission's request for comment, we generally feel that rulemaking requiring investment advisers to deliver account statements and to disclose their advisory fees in those statements is unnecessary. We believe that retail clients of registered investment advisers almost all uniformly receive account statements from their qualified custodian. The vast majority of these statements already specify the dollar amount charged for advisory fees and expenses. Based on our understanding, the three largest custodians who provide services to independent investment advisers all provide account statements to the end-client containing information about the investment adviser's fees. Therefore, we believe a rule requiring investment advisers to provide account statements would be unnecessarily duplicative. To the extent that the Commission determines rulemaking is necessary to address any retail investor confusion, the Commission should permit investment advisers to rely on their custodian for delivery of account statements containing fees and expenses, and such delivery should be permitted through electronic means consistent with current Commission guidance.

Ultimately, we believe it is appropriate for retail investors to accept some responsibility in reading the provisions of their investment advisory agreements that contains information about the fees and expenses that they have agreed to pay. Most, if not all, retail investors enter into written investment advisory agreements with their investment adviser that contain a description of the fees that they pay. Anecdotally, most investment advisers to retail investors charge either asset-based fees or fixed-fees and base their fees on the amount of assets that clients invest with them. Investors should all generally be aware of the arrangements that they have agreed to with their investment adviser. The fees that retail investors pay are already memorialized in several locations, including, but not limited to (1) their investment advisory agreements or a separate fee schedule to their agreement, (2) within the investment adviser's Form ADV Part 2A, and (3) in their custodial statements received from their qualified custodian. To the extent that the investment adviser has negotiated their fees with the retail investor and those fees differ from the fees included in the investment adviser's Form ADV, the retail client should be aware of the rate they are paying, because they would have directly negotiated their fee. Lastly, retail investors are always free to ask their investment adviser representative for information about the fees that they pay. For these reasons, we don't believe a rule is required to enhance the awareness of the fees that retail investor pay.

c. Financial Responsibility

We applaud the Commission for requesting comment on ways to improve the likelihood that investment advisers will be able to satisfy a judgment in favor of a retail investor arising from an investment adviser's wrongdoing. We believe that the vast majority of investment advisers are insured with appropriate coverage or self-insured with sufficient reserves. However, we acknowledge that there is a handful of advisers who engage in risky investment strategies; are uninsured or underinsured, and pose risk to retail investors. We believe that the Commission should carefully consider the effects of increasing regulatory compliance costs for the vast majority of investment advisers to benefit the small minority of retail investors who receive services from this category of investment advisers. The Commission should focus its efforts on examining these investment advisers on a more frequent basis. Should the Commission need assistance in identifying this category of advisers, it may consider revising Form ADV to pose questions about whether an investment adviser maintains errors and omissions insurance and the amounts of their coverage.

The Commission should also focus on the disclosures that these investment advisers make to their clients about their client's potential for risk of loss and the potential that the investment adviser may not have sufficient assets to pay a judgment in the event of their negligence leading to client losses. Additional net capital or bonding requirements would unfairly burden smaller investment advisers and create a barrier to entry and consolidation in the industry, which would further limit retail investor's choices. This barrier to entry and consolidation could inevitably lead to increased costs of investing for retail investors.

We believe that the custody rule under the Advisers Act adequately prevents the potential for misappropriation of client assets. The likelihood for fraud still exists where investment advisers do not comply with the custody rule, and we believe that the individuals perpetrating the fraud will find ways to defraud investors no matter the protections afforded by regulation. We believe that subjecting investment advisers to an annual audit requirement would also unfairly burden smaller investment advisers, create a barrier to entry, increase consolidation, limit retail investor's choice, and lead to increased costs of investing for retail investors.

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Thank you for giving us the opportunity to comment on the Commission's proposed interpretation of the standard of conduct for investment advisers under the Advisers Act.

Yours truly,

Max L. Schatzow