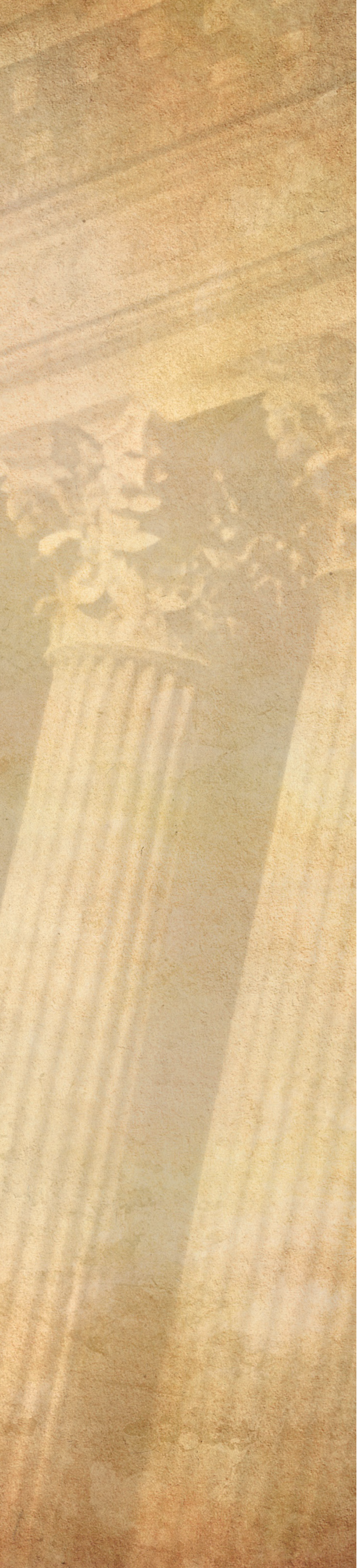

BINGHAM PRESENTS:

Harmonization of Regulation of Investment Advisers and Broker-Dealers

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Excerpts from an industry roundtable presented by Bingham McCutchen LLP in association with the SEC Historical Society, September 29, 2010, in which industry leaders discuss the key harmonization issues, including fiduciary duty and standard of care, discretionary and non-discretionary business models, principal trading, 12b-1 fees, disclosure and an SRO for advisers from a variety of perspectives that broker-dealers and investment advisers will be addressing over the next year.

Moderator:
Erik R. Sirri, *Professor of Finance, Babson College; former Director of the Division of Market Regulation (later the Division of Trading and Markets), U.S. Securities and Exchange Commission*

Participants:
W. Hardy Callcott, *Partner, Bingham McCutchen*
Michael J. Sharp, *General Counsel, Jefferies & Company*
David G. Tittsworth, *Executive Director and Executive Vice President, Investment Advisers Association*

"The regulatory regime for broker-dealers is very extensive, and very rules-based."

"...investment adviser regulation...is less rules-based, certainly much more of a principals-based scheme."

Erik Sirri: Last year's Bingham Presents looked at the new world of financial regulation and the global financial crisis of 2008. A year later, that new world is becoming a reality with the passage of the Dodd-Frank Act.[1] This roundtable will look at one aspect of this changing world, the harmonization of the regulation of investment advisers and broker-dealers.

To summarize where we are right now: The FPA decision[2] dealt the SEC a bit of a setback with regard to its approach to fee-based brokerage accounts that provided a certain amount of advice. As part of its regrouping process, the SEC commissioned the Rand Report,[3] which contained a number of salient findings including the following. First, investors had a difficult time in distinguishing among who is an investment adviser and who is a broker-dealer, especially in light of the "we do it all" positioning of the providers. Second, investors liked certain traits of investment advisers, including disclosure requirements, legal duties and compensation structure. But they also liked some traits of the broker-dealer model, such as account minimums and industry certifications, as well as the model's lower cost. Third, investors generally tended to be happy with their financial service providers, and seemed to value personal service and attentiveness over expertise in performance. Fourth, investors acknowledged that they did not really understand the fees they pay for investments and services, and that they don't read the disclosures.

Let's start with the first two issues. Hardy, what do you see as the benefits and shortcomings of the broker-dealer regime?

Hardy Callcott: The regulatory regime for broker-dealers is very extensive, and very rules-based. Broker-dealers are subject to examinations by the SEC and every SRO that they are a member of. If they do business with the public, they must also be members of FINRA and subject to examination by the states in which they do business. So there are a lot of cops on the beat.

1 *See* Bingham's summary of the Dodd-Frank Act at http://www.bingham.com/Media.aspx?MediaId=11004.

2 *Fin. Planning Ass'n v. Securities & Exch. Comm'n*, 482 F.3d 481 (D.C. Cir. 2007).

3 The Rand Report, http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf. *See* Bingham's client alert *SEC Releases RAND Study on Investment Advisers and Broker-Dealers* (January 2008) at http://www.bingham.com/Media.aspx?MediaID=6394.

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Erik Sirri, Hardy Callcott, David Tittsworth, Michael Sharp

Erik Sirri: What about shortcomings?

Hardy Callcott: I would say the main shortcoming of both the broker-dealer and the investment adviser model is there is too much non-compliance with the rules — not just technical violations, but out-and-out fraud violations. There are several hundred a year brought by the SEC against the adviser industry and the broker-dealer industry, in addition to more than 1,000 cases a year that FINRA brings against the broker-dealer industry. After all the resources the industry has put to compliance and supervision, this is not the end result you would hope to see.

Erik Sirri: David, can I ask you the same question with regard to investment advisers?

David Tittsworth: Absolutely, although I am not sure I heard any weakness for the broker-dealer regime. But I believe that a main weakness of the investment adviser profession is that the SEC does not have enough resources to police a growing industry. We put out a report for the last 10 years that shows a steady growth of advisers, from about 7,000 in 2001 to more than 11,000 today. The SEC resources, at least post-Sarbanes-Oxley, have stayed relatively constant, with 450 examiners to oversee 11,000 advisers and 9,000 investment companies. That's not enough. Dodd-Frank will change that: they are going to more than double the SEC resources, going from $1.1 billion to $2.25 billion by 2015. They are also going to reduce the number of advisers significantly when 4,000 or so investment advisers are shifted from SEC to state regulation. So I think that the SEC is well on its way to having more resources to deal with this growing population. But going to the strengths of investment adviser regulation—it is less rules-based, certainly much more of a principals-based scheme. I think that's appropriate for the profession, yet with the broad anti-fraud authority vested with the SEC, you have an overarching fiduciary duty that I have a feeling we will be talking about today.

I should point out that there are still lots of rules, from insider trading to proxy voting to codes of ethics to advertising to custody to record keeping, Form ADV, and pay to play. On top of that, you have what's known as the compliance program world that the SEC adopted in 2004, which fills in all the spaces and says, "Every investment adviser will have policies and procedures based on their characteristics to prevent violations of the securities laws." So given the diversity of the investment adviser profession and its historical evolution, I think this principals-based scheme is very appropriate.

Erik Sirri: Let's talk about the question of suitability versus fiduciary duty, understanding that it can be a false comparison.

Hardy Callcott: From the broker-dealer perspective, I think most of the industry has stated through trade associations and individually that they are not opposed to having a fiduciary duty standard. The majority of disputes with customers get resolved in an arbitral forum at FINRA in front of non-lawyer arbitrators who don't really understand the legal difference between suitability and fiduciary duty, and the result is that brokers generally think they are held to something very close to a fiduciary duty already. So certainly you can point to legal cases where a court found a violation of fiduciary duty, or wouldn't have found a violation in suitability duty, but I think the practical reality for most people in the brokerage industry is that there hasn't been much of a difference.

That said, the primary comment from the broker-dealer industry has been, "Give us as much specific guidance you can about as many different circumstances you can, and we will comply with that guidance."

David Tittsworth: There is clearly a difference between suitability and fiduciary duty. It isn't that one is bad and one is good…both investment advisers and broker-dealers are comprehensively regulated, and there are lots of headaches on both sides. But if there wasn't a difference between suitability and fiduciary duty, I am not sure we would be sitting here. You see it in the brokerage industry and probably even more on Capitol Hill, where unfortunately I had to spend a lot of my time over the past few years. The insurance industry is absolutely adamant in saying fiduciary duty is something they don't want to have imposed. Why? All you attorneys out there, it's because of potential liability. It's because they are scared they are going to be limited on the brokerage side by the principal trading restrictions under the Advisers Act, and they don't want to make the disclosures that advisers are required to make.

"…the main shortcoming of both the broker-dealer and the investment adviser model is there is too much non-compliance with the rules…"

"…saying that the shortcoming is that people violate the laws is like saying that the problem with red lights is that people drive through them."

David Tittsworth

That is part of what makes fiduciary duty different from suitability. But simply stated, fiduciary duty on the adviser's side has been settled by law since 1963, when the United States Supreme Court ruled that there is a fiduciary duty under the Advisers Act. The words never appear in the statute, but under Section 206, the anti-fraud provision, it says there is a duty to, at all times, put the interest of your clients ahead of your own. Last year I had the pleasure of sitting before the House Committee on Financial Services, and at my table were the head of the state securities regulators, the head of FINRA, a consumer advocate, a representative from SIFMA, brokers and an insurance industry representative. The ranking Republican, Spencer Bachus, asked, "Listen, I have heard all these arguments about suitability and fiduciary duty. I want to know, is there is a difference, and is fiduciary duty a higher standard?" And every person at that table said, "Yes, fiduciary duty is a higher standard. There is a difference."

Erik Sirri: Mike, what do you think?

Michael Sharp: First of all, to get back to the earlier point with respect to shortcomings on both the investment adviser and broker-dealer sides—saying that the shortcoming is that people violate the laws is like saying that the problem with red lights is that people drive through them. People who adhere to the red lights stop their cars. People who adhere to the laws act properly on both the adviser and broker-dealer sides.

I believe there is a practical difference between investment advisory and broker-dealer, that they are viewed differently by the Street. There are a lot more safety nets on the investment advisory side, with performance being a key indicator that you don't have on the suitability side. People look at performance. In general, you are not going to get people on the broker-dealer side changing their habits or changing practices based on performance.

Erik Sirri: As many of you know, one of the requirements of Dodd-Frank is that the SEC do a study about the harmonization of the adviser and broker-dealer standard in order to determine a uniform standard of care. What are the most important questions the SEC should ask (and answer) when they do this, given that the Rand study has come and gone?

David Tittsworth: We know that our friends at the SEC have been looking at this issue, and I think they are asking the right questions, which have to do with what do investors think. Are they confused about the standards that are out there and the activities of broker-dealers and investment advisers? Clearly the answer is yes. But they are also asking whether there are gaps or overlaps between the broker-dealer and investment adviser regimes. And that's where you can get into a lot of discussions well beyond fiduciary duty, which has been the most visible issue.

Hardy Callcott: I think we've touched on some of the things the SEC should look at and is going to look at, including differences in enforcement and examination, resources, and the substance of the respective regulatory schemes. Another important issue involves the cost and availability of investment advice to individual investors. A surprising finding from the Rand Report was that a large number of investors surveyed said that either they, their family members, or people they knew had trouble getting investment advice at all. We know that some firms have gotten out of the business of providing individualized financial advice because of the liability issues caused, in part, by increased regulation. On a legal level, I agree that fiduciary duty is a higher legal standard than suitability. The question is, how can the SEC raise the standard without causing even more ordinary Americans to be pushed out of getting investment advice at all?

Erik Sirri: The statute defines what it means to be a retail investor and talks about the term personalized investment advice. I think it is somewhat of a key phrase, because this question about duty in the uniform standard of care relates to the receipt or the delivery of personalized investment advice. What is the definition of personalized investment advice, in this context, and how should it be divvied up?

David Tittsworth: I don't think there's a definition, the SEC is on its own. But I think when you look at it, it's advice that is tailored to an individual. So I would say that if I'm a broker-dealer putting non-specific research out there about emerging markets or fixed income or whatever, that's not personalized investment advice. But if you come to me with $50,000 and say what should I do and I make a specific recommendation of a security, that's clearly personalized advice. There are gradations in between, I get it.

Erik Sirri: So if I am the adviser/broker and I say 60/40 stocks and bonds, is that personalized advice?

David Tittsworth: I think asset allocation absolutely is investment advice. I believe the SEC has been consistent about that for a long time. But it's not quite as specific as saying, "I want you to buy 500,000 shares of Sirri International."

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Hardy Callcott, Susan Merrill, Erik Sirri, Herb Janick, David Tittsworth

Hardy Callcott: I agree with David that generalized research reports are not personalized investment advice. I would argue that investment tools where an investor can go online and run different scenarios, and it's the investor making the choices rather than the financial adviser, are not personalized advice. I think one question is, can you give personalized investment advice and then step back and be a broker again? Can you have someone come in and get a snapshot financial plan without thereby having an ongoing duty to monitor what that customer does in their account? If they are doing unsolicited trades that are contrary to what you had advised them, do you have a duty to step in and say, "Wait a minute, I didn't advise that?" I think the question of ongoing obligation is an area where the SEC would do well to provide more clarity.

Michael Sharp: I have a slightly different view on this. I think it's very easy to define what personalized investment advice is, but although the Street has been doing it for decades, it may not have been memorialized in a certain way until now. So codify it, memorialize it—I think this is a relatively easy thing to do. I think the biggest issue, to be frank, is that the Street has strenuously avoided taking on fiduciary responsibility. On one level, all the big wire houses will publicly say that investors need a choice and things need to be done so investors have choice. But internally, they push their people to be investment advisers because it's better business. And there is a disconnect between what they push their people to do internally and the public positions they take that causes all of these questions to be raised.

David Tittsworth: Could I just jump in? Our organization, the Investment Advisers Association, has said that brokers who are doing the same thing as investment advisers should be treated the same way under the law. I think, in general, most of us could hold hands and agree that people doing the same things should have the same legal obligations. So we are not saying, by the way, that brokers should be a fiduciary in all situations. It's only when they are providing investment advice. Brokers do a lot of things other than providing investment advice. A broker is a person who effects securities transactions.

Michael Sharp

Erik Sirri: David, I want to ask you something in regard to your previous point. Could a broker make a solicited trade and have it not be advice, in the way you are formulating advice?

David Tittsworth: That's the million dollar question, right? I think there is a continuum. Discretionary advice, I think everybody would agree. If anyone gives discretionary advice, a person who calls himself a financial adviser, broker-dealer, whatever, I think that that is fiduciary duty standard.

Erik Sirri: Does anyone want to caveat that? Okay, you got one.

David Tittsworth: Now I am looking at Schwab's comment letter on this Section 913 study,[4] and I guess they start out with high-end, comprehensive wealth management, including discretion to trade as well as comprehensive planning advice across a range of non-investment financial matters. Then they have discretionary investment portfolio or account management, and then non-discretionary investment advice or program for a fee. I think that we would all agree that these are subject to the fiduciary duty under the Advisers Act.

Hardy Callcott: With the caveat that the fiduciary duty itself is a sliding scale, I would argue higher duties to a discretionary account.

David Tittsworth: I think the fiduciary duty under the Advisers Act is what the Supreme Court ruled in 1963 is the fiduciary duty under the Advisers Act.[5] But I also think that just because someone has fiduciary duty doesn't mean that you accept ongoing portfolio management responsibilities. Even if you are a fiduciary, if you come to me and say, "Here is my money. What should I do with it?" And I say, "Look, I am willing to give you some advice right now, but I am not going to monitor this account on an ongoing basis. I think I can do that as a fiduciary but I am telling you up front." So, to me it's more like saying, "Will you and I, the client and the adviser, agree that the person giving advice can have that scope of fiduciary duty?" And if that's the sliding scale you are referring to, Hardy, I think we are more in agreement than not.

Hardy Callcott: Why should I with disagree that point? But I think that is not a sliding scale.

Michael Sharp: I think that is not a sliding scale. I think if you have a fully discretionary account and the client doesn't make the decision, that's fiduciary. I think if you have a non-discretionary advisory account, that has equal fiduciary responsibility. And when you see that client moving away from what you are advising him to do, as a fiduciary you have to fire the client. That client is rejecting your advice, and as a fiduciary doing that which is in the best interest of your client, you can't get paid.

> **"…just because someone has fiduciary duty doesn't mean that you accept ongoing portfolio management responsibilities."**

4 *See* Schwab comment letter at http://www.sec.gov/comments/4-606/4606-2670.pdf.

5 *SEC v. Capital Gains Research Bureau, Inc.*, 375 U. S. 180 (1963).

Erik Sirri: **I just want to echo what you said, Mike. When we were working on this at the Commission, a number of people from large firms came in and made the point about firing your client. I think it's really to protect the firm as much as themselves.**

Michael Sharp: Absolutely.

Hardy Callcott: I will see your 1963 and raise you to 1943.[6] Fiduciary duty isn't the end of the analysis, it's just the beginning. What is the scope of the fiduciary duty? What is the nature of the breach? What is the remedy for the breach? Fiduciary duty isn't really a uniform standard. A fiduciary duty in, for example, a trust context where you have duties to beneficiaries who may not even be born yet is completely different from a fiduciary duty in a non-discretionary advisory account. It is in my view fully permissible to say I am going to give you advice today, and then six months later we are going to sit down again, but I am not going to talk to you in the intervening six months. The law allows you to negotiate the scope of fiduciary duty. But fiduciary duty has become a sort of slogan, when in fact it is a much more complicated concept.

Erik Sirri: **There is a letter to the SEC[7] written in response to the FPA decision by current SEC chair Mary Schapiro back in 2005, when she was at FINRA, in which she describes fiduciary duty. She points out, "[Third,] the contours of an adviser's 'fiduciary duty' are imprecise and indeterminate. Indeed, these contours have been developed unevenly over time, and much of what the FPA describes as the adviser's fiduciary duty is more implied than expressed." I am not trying to rope someone in on their past comments. I just don't know how to look at that comment here.**

Michael Sharp: That letter was filed with the SEC in a broker-dealer exclusion context that the FPA decision unfortunately invalidated. So I have certainly wondered about that as well, and I hope that all the Commissioners keep an open mind. I would disagree with the notion, as I read that letter and you have just read one sentence from it. But to me, it basically says the broker-dealer regime is better than the investment adviser regime. Are either one of them perfect? Probably not. But I think it's counterproductive to start a discussion with the idea that one is better than the other.

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Hardy Callcott

Hardy Callcott: I think that's a key point. They are different. Investment advisers are more expensive and you get more for your money. But if you don't want that then you go to a broker-dealer model. It's that simple.

Erik Sirri: **Hardy, I think, mentioned this a little earlier. He talked about costs, and as I read Section 913 of the Dodd-Frank Act, it clearly asks questions about costs. This goes hand in hand with the other thing Hardy mentions, which is choice. If you elevate the standard, you run a risk of cutting off a basket of services that is clearly valued by a segment of society. On the other hand, within that basket you may be delivering some modicum of advice, and you have to make a trade-off. Do you want to cut off that valuable portfolio of services, which are low-cost and efficient, but may contain advice? That seems essential in trying to figure this out. And I think it ties in to the principal transaction question. Even though Section 206(3) [of the Advisers Act] is not talked about in this portion of Dodd-Frank, what are your thoughts on the principal transaction?**

"…fiduciary duty has become a sort of slogan, when in fact it is a much more complicated concept."

6 *SEC v. Chenery Corp.*, 318 U.S. 80, 85-86 (1943).

7 Letter to Annette L. Nazareth and Meyer Eisenberg from Mary L. Schapiro and Elisse B. Walter (April 4, 2005).

> **"You can't have an advisory program, certainly a non-discretionary advisory program, without principal trading."**

Michael Sharp: It's not talked about, but they do expressly state that you wouldn't be violating their proposal by having the ability to sell principal products. I think after the FPA decision and the whole change in the law to what is now the non-discretionary advisory model, the question was answered. You really can't do this without allowing principal trades. And what you have in place right now is a regime that is unworkable: You have a call for the non-discretionary advisory model where you don't have to get trade-by-trade written consent.

Hardy Callcott: But that [Rule 206(3)-3T, which allows for blanket consent to principal trades] goes away at the end of this year and the SEC said they are not going to renew it.

Michael Sharp: That's fine. What's happening right now is that the Street is mobilizing. You can't have an advisory program, certainly a non-discretionary advisory program, without principal trading. And I think you can't have an effective discretionary advisory model without principal trading. You just need to be careful about overcharging people. For instance, if you have a discretionary advisory model you can't buy IPOs, or you buy them but then they sit in a separate broker-dealer account for some number of months before they go in, so you don't charge people too much. You are missing very useful structured products. There are many, many instances in which having that ban will make it unworkable to have principal trading, and if you don't allow principal trading you will not have the ability to give sound investment advice.

Hardy Callcott: I guess the other area that people regularly point to is fixed income: bonds, municipal bonds and, to a lesser extent, corporate bonds. For retail investors who are buying and selling small lots, you don't get good prices if you have to do agency trading away from your firm. And so if the result of adoption of a fiduciary duty standard is worse executions for retail customers on fixed income, the SEC should try to avoid that.

Michael Sharp: I recently met an investment adviser who used to work for a brokerage firm, and she was saying that she got tired of selling fixed income products that were marked up by her brokerage firm. So I think it goes both ways. Look, to me, 206(3) and the Advisers Act restrict principal trade, and you have to get the consent of the client on a transaction-by-transaction basis. A lot of people tell me this is effectively a ban on principal transactions, since it's very difficult to get that consent. But what I don't understand is that the SEC has brought exemptive authority under 206, so if all these wonderful things that are talked about in principal trading involve an inherent conflict of interest...maybe there are all sorts of reasons why those conflicts can be mitigated or disclosed. But why doesn't anybody go in and ask for exemptive relief from the SEC?

Hardy Callcott: They have. People have applied and been turned down. Although I will say that a lot of firms relied on the temporary Rule 206(3)-3T, which is going to expire. The SEC Division of Trading and Markets has suggested, "Okay firms, come in and get individual exemptive relief, now we will be open to that." But I think there are clearly situations where principal trading is beneficial. I am from California, where we have very high state taxes. California State Bonds are desirable investments, so for the firm to be able to go out and buy them and have them in inventory for customers if they want them, that's a benefit to customers. And when the customer wants to sell and you are selling five bonds or 10 bonds, and you have to go out and bid that to the Street as opposed to having the firm buy them into inventory, you are just not going to get a good price. So again, if the result of fiduciary duty is worse executions for customers, that's a bad result.

Erik Sirri: **Let me turn to something else that is in the air, not often associated with the IABD question but interesting nonetheless. Most of you probably know that Buddy Donahue at the SEC and the Commission proper have proposed revisions to Rule 12b-1, including caps on 12b-1 payments. A number of people have pointed out that, in the debate between business models, one of the great things about the broker-dealer model was that you had this flow of 12b-1 fees. In a world where an enhanced standard of care arises and 12b-1 fees are capped, are any of you worried that these forces will drive us away from a vibrant broker-dealer model and into the advisory space?**

Hardy Callcott: For load funds — putting aside no-load funds, which have a different set of issues — 12b-1 fees have been a way that customers can pay for advice over time, as opposed to making an upfront payment. And I think they have worked for the sort of mid-level investors who don't have a high enough net worth to be of interest to full registered investment advisers. The issue is, there have been situations where broker-dealers have sold load funds to customers when the customer would have been better off in a different kind of account relationship. So one of the issues that comes up, both on the brokerage side and on the advisory side, is finding an account structure that is right for a particular customer and is the right way to charge for the advice. It's a hard line to draw, but I would argue that there are investors for whom load funds have been the only way they can effectively get investment advice.

Michael Sharp: The biggest flaw of 12b-1 is its name. If you just call it ongoing sales charges, you would be much clearer to people. And no matter what you call it, the market will demand a certain amount of money to exchange a transaction. What we need is more clarity and more transparency.

> **"The biggest flaw of 12b-1 is its name. If you just call it ongoing sales charges, you would be much clearer to people."**

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Erik Sirri

Erik Sirri: **I think that's one of the things that the new rule hopes to provide with the account level charges. When Hardy characterized the 12b-1 fees as paying for advice, I think a fund person might have pointed out that they pay for distribution. I think we get the parallel, but it's sort of an interesting way to look at it.**

Let me go back to something in the Rand Report that I mentioned earlier — the question of disclosure. Keeping in mind that this is about improving the quality of services to investors, if you take the Rand Report at its face, disclosure is not read, even if crafted well. But as many people have pointed out, disclosure is an important part of the fiduciary duty because it is part of shaping and describing it in a very active way. How should we think about relying more on fiduciary duty in a world where the retail investor is not reading the disclosure? Does that disturb you?

David Tittsworth: It disturbs me. I think it disturbs everybody. I talk to members of our organization and they want sophisticated clients — people who understand what they are doing. So you have to read some stuff, I think, to get to that point. I know it's a problem; it's a problem for me. I get stuff in the mail from banks and my modest investments, and most of it I throw in the trash. People tend to trust their adviser, whether he or she is a broker, a planner or an investment adviser. It's human nature and we don't want to read that stuff.

Still, I don't think you throw disclosure out the window. Those of you who are familiar with the investment advisory profession, you know that the SEC has just adopted a final rule on Form ADV Part 2, a plain English disclosure. But you always have this tension between full disclosure, and is it understandable or readable, much less is anybody going to read it? I wish I had the solution. I think it's education and you keep trying to pound it in.

Hardy Callcott: A couple of thoughts on disclosure: It is generally true under the Restatement of Agency that with full and fair disclosure a client can consent to a conflict of interest on behalf of the agent. That being said, there are limits to that proposition, and you can't disclose your way out of a conflict if the client doesn't have a basic understanding of what is being disclosed. I think there are some products that are sufficiently complicated that even if you put the full disclosure in front of them, some investors are just not going to understand. And I don't think you can go forward and sell that product just because you have made a disclosure. Beyond that, under state law there's a prudent investor standard that applies to fiduciaries, and that's a substantive standard. And you can't disclose your way out of that standard, either. So, disclosure is helpful but I don't think that disclosure is, at the end of the day, the panacea for brokerage firms.

"The notion that people don't read disclosure doesn't bother me. Disclosure is a liability limitation for the Street..."

"I talk to members of our organization and they want sophisticated clients—people who understand what they are doing."

Michael Sharp: The notion that people don't read disclosure doesn't bother me. Disclosure is a liability limitation for the Street...I have never read a prospectus unless I had to litigate one in my life. But this doesn't just cut against the advisory model. I think that, when you start to read some of the comment letters that have come in, folks who are favoring the brokerage model say, "You need to streamline it, you can't go with trade-by-trade disclosure for principal trade. You need to upfront this." Well, in a world where people aren't reading disclosure, what good is putting it up front? No, but people do read disclosures. And again when we built the non-discretionary model there was a special box, they had to sign multiple times. One of the boxes they had to sign was, "Please understand that we will be trading as principal." But then you have other backstops in place to protect the client, and to protect you if the client decides to just sign on the bottom line.

Erik Sirri: That would strike fear in the hearts of the ex-Commission employees.

Hardy Callcott: I understand that.

Erik Sirri: Let me touch on a question that's often brought up in this space, the question of an SRO for advisers. I know it's a bugaboo, but it is clearly something that is in the air once again. Let me start with David—are belts and suspenders unnecessary? It's been written about for years.

David Tittsworth: Absolutely unnecessary. It's an extra layer of bureaucracy and costs; self-regulation by definition involves an inherent conflict of interest. Good friends of FINRA are obviously lobbying actively to become the SRO for investment advisers. But I think FINRA especially is poorly suited to regulate the investment adviser profession: lack of transparency, lack of accountability, a bad track record, the costs involved and, perhaps most important, a bias favoring the broker-dealer model.

Erik Sirri: Could FINRA be fixed up to make it the best entity? Or could another SRO rise?

Hardy Callcott: As I said earlier, more cops on the beat is better than fewer cops on the beat. In the past several years, the SEC has examined only about 9 percent of SEC-registered investment advisers. A number of states, prominently including New York, don't examine state-registered investment advisers at all because they don't have authority to do it. David said, and I think we all agree, that the SEC should get more resources in order to do more examination on the investment adviser side. But right now, there is only one cop on the beat for any investment adviser. And in many states and at the federal level, that cop is not on that beat nearly often enough, and that problem needs to be solved. If the SEC had gotten self-funding in Dodd-Frank, maybe the SEC could have solved it. But it needs to be solved, and my personal opinion is that an SRO that has the ability to fund itself from the industry, as opposed to having to go to Congress for appropriations, is the only way it is going to get solved.

Michael Sharp: I think where you stand on this issue depends on what you sit. Being at a large wire house and then being at other places, I don't believe the notion of FINRA not regulating investment advisers. It happens all the time. When we were building non-discretionary advisory models, we went with the dog-and-pony show to everybody including FINRA because we knew they would come in and look at it. It is true that they don't go to pure investment advisers. And I think it's better to have more cops on the beat than not. <

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