

June 13, 2017

Chairman Jay Clayton
U.S. Securities and Exchange Commission
100 F Street, NE
Washington DC 20549

Dear Chairman Clayton,

On behalf of CFA Institute¹, I would like to congratulate you on your appointment as Chair of the Securities and Exchange Commission. Chair for the world's leading financial markets regulator is a position of significant importance to investors, issuers and intermediaries, not just in the United States, but for global financial markets participants, as well. I wish you great success in your tenure in this august role.

CFA Institute is a global organization known best for the globally renowned Chartered Financial Analyst program and designation which CFA Institute offers and oversees to enhance the technical and ethical understanding of investment professionals. We have nearly 150,000 such professionals as members who operate across the broad spectrum of global financial markets. While the bulk of our members in the United States operate on the "buy side" — nearly 40% have wealth management responsibilities — our members also function on the "sell side," in consultancy and academic roles, and in the legal and accounting professions. The unifying element of our members is their annual attestation to our Code of Ethics and Standards of Professional Conduct which, among other things, requires that they put their clients' best interests ahead of their own interests and ahead of those of their firms.

As a long-time proponent of investor interests, we regularly hear from our members about the issues they think financial regulators should address. The United States Advocacy Advisory Committee — comprising 14 members representing a cross-section of our 67 large, mid-sized and small societies spread across the United States — developed a list of the capital markets issues they think are most important for the SEC and CFA Institute to address. On the pages that follow, we provide this list, together with two important financial reporting issues, including a description of why we think they are important and how we think the Commission can help resolve these matters.

¹ CFA Institute is a global, not-for-profit professional association of more than 149,000 investment analysts, advisers, portfolio managers, and other investment professionals in 163 countries, of more than 143,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 148 member societies in 73 countries and territories.

We recognize that many of the recommendations on these issues will require the Commission to invest in technology and human resources. Consequently, we will actively support greater appropriations for the Commission so that it can invest in these assets to further protect investors in U.S. capital markets.

We welcome your feedback, and we look forward to developing a dialogue with you, your office and your fellow commissioners in the coming months and years as we seek to address these very important issues.

Policy Priorities of CFA Institute Members

1. Fiduciary Obligations of Investment Professionals.

CFA Institute strongly supports a fiduciary standard for all who provide personalized investment advice to retail investors. We are acutely aware of the difficulty the Commission faces in attempting to draft a uniform standard for everyone providing such advice, as it would likely involve numerous exemptions and carve-outs for different types of clients, transactions, and situations.

We believe the Commission can effectively begin to regain control of this issue by regulating the titles that those who provide personalized investment advice can use. We, like the Commission's Investor Advisory Committee², recommend that the Commission require that anyone wishing to refer to their title and/or activities as advisory in nature (e.g. "adviser" or "advisor") adhere to the Investment Advisers Act and the fiduciary duty implied by common law interpretation of the Act. Such control of terminology would not be new to the Advisers Act, which already expressly limits use of the term "investment counsel" to those who must adhere to the Advisers Act's requirements³.

At the same time, we believe commission-based sales activities serve important client needs and give investors options for how they wish to conduct their investment activities. Whether commissioned brokers provide investment ideas or execute trades, we support that they be permitted to pursue their business activities, so long as they are clear about their roles vis-à-vis their clients. Specifically, we recommend that the Commission require that they refer to their roles with the title, "salespersons." For too long, these sales staff have blurred the line between what they do – selling investment ideas to generate commission-based transactions – and

² See <https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation.pdf>. As stated by the IAC, the approach described above would "ensure that the existing legal precedent, staff interpretations, and no-action positions developed under the Adviser's Act and accompanying rules would also apply to investment advice by brokers. And it would achieve this without the necessity of creating a whole new parallel body of law under the '34 Act."

³ Section 208 (c).

what investment advisers do – advising clients on investment strategies and tactics to achieve their financial goals.

We believe that once the issue of titles is addressed, the SEC will have a clearer idea of what kind of rules are needed to address other aspects of the standards-of-care issue. We stand ready to help make these changes, changes that we believe will have long-term benefits for investors and U.S. capital markets.

2. Risk and Fee Disclosures for Investment Products and Services.

The expansion of investment products into more complex collective investment funds and services has brought a parallel need for improved disclosures. The two areas our members say need the greatest improvements are related to fees/costs and risks.

The cost of investment products and fees for services are often spread across an array of potentially confusing terms, from management and transfer agent fees to so-called 12b-1 fees, not to mention transaction, custody and legal costs, among others. We believe investors deserve to understand what these costs are, how much they are, and most importantly how they will affect their ultimate investment outcomes. Unless investors are aware of these costs and understand how they affect their returns, they cannot appropriately compare and contrast different investment products and may lose trust in the investment sector and in the financial markets, in general.

To help allay these concerns, we recommend that the Commission launch a review the required fee disclosures for investment funds and advisers with a goal of ensuring they are comprehensive and understandable, and convey how these costs affect investors' ultimate investment outcomes. We support the Investor Advisory Committee's recommendations regarding mutual fund cost disclosures⁴ as an important contribution toward enhancing investment cost disclosures, and we stand ready to offer our comments to the recommended review.

We also encourage the Commission to review disclosures related to risks that may affect investor outcomes. Exchange-traded products, for example, give investors the impression they are freely tradeable on exchanges, whereas the reality of limited markets for many bespoke ETFs is that investors may endure long delays for execution of trades and then get execution at prices vastly different from what was previously quoted.

Investors also need to be aware of other risks they face with the purchase of synthetic exchange-traded products, such as those related to counterparties, lack of

⁴ See <https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-041416-recommendation-investor-as-purchaser.pdf>

collateral control and securities lending. CFA Institute members have expressed concern that investors may not be aware of many of these risks, nor understand what they may mean for their investment outcomes. Moreover, the “boilerplate” lists of risks for such instruments raise questions about how two dramatically different ETFs may have all such risks in common.

Based on this feedback from our members, we recommend that the Commission review its existing risk disclosure requirements with a goal of enhancing the quality of such disclosures across the spectrum of investment products. We believe doing so will enable investors and their advisers to make truly informed decisions, and we are prepared to offer investors’ views to the Commission as part of its review.

3. Regulation of Investment Products and Services Deploying Financial Technologies.

In early 2016, CFA Institute surveyed its membership to gauge the degree of angst or comfort they held for emerging financial technologies, such as automated advisers (aka, robo advisers). In general, our members saw these technologies providing important investment services to investors who have limited assets to manage. They also saw the technologies as offering access to a wider range of investment products and services than these clients would normally see.

At the same time, members saw risks in the new technology-based products and services that could pose greater challenges for regulators and investors, alike. For example, there was concern that the algorithms behind such offerings may have embedded computer code that produce recommendations directing clients toward products that benefit service-providers rather than clients. They also noted that the untested nature of the technologies in times of stress could lead to advice that worsens, rather than aids, the investment outcomes for investors.

We also have heard from our members and others that the oversight and regulation of financial technologies is not on par with the regulatory requirements imposed upon traditional advisers. In particular, they expressed concern that the technology firms developing the algorithms may not be aware of, or in some cases not see the applicability of, existing adviser regulations for such services. We have heard that these kinds of issues affect both within *de novo* automated advisers as well as banking operations acquiring these technologies to advance their internet service offerings. And finally, our members have an interest in how the Commission intends to ensure that investors are appropriately protected in regards to distributed ledger technologies (blockchain) and crowdfunding.

To prevent unnecessary investor losses, both for those investing through automated platforms and for investors in the firms offering these platforms, we urge the Commission to step up its examination and enforcement of existing adviser regulations as they apply to automated advisory firms. At the same time, we

recommend that the SEC clarify for these firms that they are subject to the same client-loyalty requirements that apply to traditional advisers. To enable the Commission to invest in systems and people needed to provide this kind of oversight and enforcement, we will advocate for greater appropriations for the Commission.

4. Enforcement of Existing Rules, Including Stepping Up Enforcement Against Cybersecurity Attacks.

In a survey of U.S.-based members about SEC priorities, CFA Institute members saw over-regulation as one of the biggest threats to U.S. financial markets, and argued that enforcement of existing rules is more important than more regulation. Nearly on par with this concern was their expressed anxiety about the threat of breaches in cybersecurity.

To combat these concerns, we recommend the SEC should, first, limit creation of new rules to those dedicated to significant investor-protection matters, such as the fiduciary duty issue noted above. Second, we urge the Commission to continue its investment in vigorous enforcement of existing financial market regulations that began with your predecessor, Chair White. Doing so will protect investors, who are an indispensable part of the capital-raising function of U.S. capital markets.

We also recommend that the Commission dedicate financial and human resources to cybersecurity efforts to further reinforce its oversight and regulation of U.S. capital markets. These efforts should include increased guidance to investment firms and investment advisers on how to strengthen their internal cybersecurity defenses. We also recommend increased investments by the Commission in information technologies to enhance its regulatory enforcement, particularly in areas related to matters of market structure.

As stated above, we realize the investments recommended herein will require greater Congressional appropriations. We will therefore support the Commission's requests for increased financial resources to fulfill these important and timely outlays to enhance its and the industry's cybersecurity defenses.

5. Non-GAAP Financial Measures.

We encourage the Commission to continue with robust oversight activities on non-GAAP financial measures, pursuant to its 2016 updated guidance. Oversight in this case would supplement rules mandated by the Sarbanes-Oxley Act of 2002, and are needed to stem the expansion of non-GAAP measures and prevent a return of the kind of unique financial metrics that misled so many investors in the late 1990s and early 2000s. Robust regulatory oversight will contribute to increasing the transparency and comparability of non-GAAP reporting and reduce the likelihood that these measures will mislead investors.

6. **PCAOB Standard on Auditors' Reports.**

We welcome and support the recently announced Public Company Accounting Oversight Board (PCAOB) adoption of a final standard requiring auditors to include significantly more information in their auditors' reports. Our longstanding support for enhancing these reports has been backed by feedback from global member surveys conducted over multiple years. Our survey results have highlighted sustained support for a change from the current pass/fail form of auditor reporting. In the United Kingdom, for example, where the recommendations of the report have been adopted, investor feedback has been positive⁵. We believe the PCAOB requirement is an important milestone towards ensuring robust and investor-friendly auditor reporting within the US.

Conclusion

While we recognize that many of the above recommendations would require greater Congressional appropriations to enable the Commission to invest in technology and human resources, we stand ready to actively support increased SEC funding as needed to protect investors in the U.S. capital markets. Moreover, you and the Commission staff can count on CFA Institute to respond to any consultation related to the above matters, in which we will provide investors' perspectives on proposed solutions.

We thank you for the opportunity to present to you the financial market regulatory issues our members have identified as most important for the SEC to address. We welcome your feedback, and we look forward to developing a dialogue with you, your office and you fellow commissioners in the coming months and years as we seek to address these very important issues.

Should you have any questions about our positions, please do not hesitate to contact me at paul.smith@cfainstitute.org or 434.951.5444.

Sincerely,



Paul Smith, CFA
President and Chief Executive Officer
CFA Institute

⁵ See [Financial Reporting Council Thematic reviews of the enhanced auditor report](#), then select report called, "Extended auditor's reports: A further review of experience."