VIA ELECTRONIC MAIL: rule-comments@sec.gov

July 29, 2020

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: **File No. 4-761**

Dear Ms. Countryman:

As a member of the Financial Services Institute (FSI), Cambridge Investment Research Advisors, Inc. ("CIRA") is writing to express support for the Petition for Rulemaking to End the Commission's Backdoor Regulation of 12b-1 Fees (the "Petition") filed with the Securities and Exchange Commission ("SEC") on April 29, 2020.[1]

CIRA supports the Petition because SEC regulation by enforcement ignores numerous, important considerations, including but not limited to the following:

- Firms want to comply with SEC rules and dedicate significant efforts and resources to do so, yet the SEC thwarts those efforts by inconsistent, sometimes heavy-handed enforcement efforts.
- Regulation by enforcement and the resulting inconsistencies and animosity it creates between regulators and industry participants directly impedes long-term investor protection, while potentially increasing costs to investors and/or limited investment options – none of which serves the public good.
- SEC "voluntary disclosure" initiatives based on an aggressive, one-size-fits-all approach fail to incentivize participation, much less compliance, leading to contentious and needless disputes among firms and the SEC.
- Threats and/or punishment against firms that make a good faith, justifiable decision not to participate in a "voluntary disclosure" initiative dampens participation and jeopardizes

[1] File No. 4-761, Rulemaking Petition to End the Commission's Backdoor Regulation of 12b-1 Fees (April 29, 2020) *available at*: https://www.sec.gov/rules/petitions/2020/petn4-761.pdf

creation of a necessary open and transparent dialogue among industry participants and their regulator.

- "Strong arm" tactics to force rule changes without notice and comment, damages the relationship among firms and the SEC and is a disservice to the industry.
- The SEC's hyper-technical, overly formalistic and semantics-based arguments in support of its enforcement efforts further shrouds compliance and enforcement efforts in uncertainty and lack of predictability, which does not protect investors, increases compliance costs for industry participants and lacks any corresponding benefits.

By way of background, CIRA is a corporate Registered Investment Adviser ("RIA") registered with the SEC. CIRA is affiliated with Cambridge Investment Research, Inc. ("CIR"), an independent broker-dealer and a member of the Financial Industry Regulatory Authority ("FINRA"). CIRA and CIR (collectively "Cambridge") constitute one of the largest, private RIA / independent broker-dealers in the country. Cambridge supports over 3,500 financial professionals nationwide, who serve over one million customer accounts.

Cambridge financial professionals are not employees but rather are independent contractors and entrepreneurial business owners. They have the freedom to structure their business in a manner that best serves their clients. These financial professionals utilize CIRA and CIR to process investment business, provide marketing assistance, assist with practice management, provide compliance and supervision oversight, and provide education.

CIRA's concern with the SEC's regulation by enforcement is evidenced clearly by CIRA's recent experience with the SEC's Share Class Selection Disclosure Initiative ("SCSDI" or the "Initiative"). CIRA participated in the SCSDI in a good faith effort to work with the SEC to review 12b-1 fee disclosures provided by CIRA to its customers.

At all times relevant to the SCSDI, CIRA's Form ADV disclosed the firm's receipt of 12b-1 revenue, as well as the potential for related conflicts of interest. Moreover, CIRA continuously enhanced those disclosures over the years.

Notwithstanding CIRA's specific disclosure efforts, which distinguished CIRA from many other firms, throughout the SCSDI process the enforcement staff viewed all firms the same. The enforcement staff ignored the meaningful, marked differences in firms' disclosures. Moreover, the enforcement staff's disregard of the meaningful differences among firms' disclosures lacks any clear basis in rule or regulation. As a result, CIRA and the enforcement staff differed as to the meaning and completeness of CIRA's disclosures.

In the absence of clear statutory direction from Congress or rules promulgated under the law, in order to conclude that CIRA's disclosures were insufficient, the enforcement staff instead relied on previous settlements, which do not reflect judicial precedent, and retroactively applied subsequent, published guidance. Cambridge believes that one of the SEC's Commissioners recognized the faulty underpinnings on this enforcement action and declined to support it. This divide among the Commissioners clearly evidences the reality that reasonable minds disagreed on the sufficiency of CIRA's disclosures.

CIRA takes its regulatory and compliance obligations seriously and places considerable time, resources, finances, effort and energy into its compliance program. CIRA continuously reviews its ADV disclosures and amends the document as needed to address regulatory priorities, public speeches by regulators, enforcement actions and advice of in-house and outside compliance and legal experts. This has been and continues to be standard practice for CIRA, dating back well-before the period at issue in the SCSDI.

CIRA's experience with the SCSDI differed significantly from CIRA's prior experiences with the SEC. As an SEC registered RIA, CIRA is examined routinely. In 2016, the SEC conducted a full, routine exam of CIRA and found no major deficiencies. In fact, as part of the 2016 exam, the examination staff specifically reviewed CIRA's ADV disclosure language related to share class selection and conflicts of interest. The examination staff found *no deficiencies* in this area.

Nevertheless, when the SEC announced the SCSDI in the winter of 2018, CIRA faced an untenable dilemma. CIRA could participate in the SCSDI, which would require CIRA, in an effort to avoid remediation under the Initiative, to argue the reasonableness of the very same disclosures already reviewed by the SEC examination staff. However, in so doing, CIRA would run the risk of the enforcement staff disagreeing with its examination staff and ordering remediation.

Alternatively, in reliance on the fact that the SEC examination staff already reviewed CIRA's ADV and associated disclosures, CIRA could decline to participate in the SCSDI. However, if the SEC rejected the examination staff's prior finding of no deficiencies, CIRA would be exposed to significant fines, in addition to other sanctions. This is not a reasonable choice.

When the SEC offers firms the ability to participate in a "voluntary disclosure" initiative, heavy-handed, one-size-fits-all enforcement actions against all participants should not follow. Firms like CIRA endeavor to comply with SEC rules and dedicate significant efforts and resources to doing so. While improvements and enhancements are always appropriate, CIRA is proud of its regulatory history and is committed to maintaining that record.

Firms cannot consistently comply with regulations when interpretation and application of the regulations change overnight, at the whim of the SEC and outside the protections and due process afforded by the notice, comment and rule-making process. SCSDI is a perfect example of this problem. It is implausible that the entire industry misinterpreted SEC regulations on the disclosure obligations related to the receipt of 12b-1 fees. Similarly implausible is that such an apparent misinterpretation spanned almost a decade. If this were true, the examination and enforcement staff would not have examined firms multiple times prior to 2018 and found only a handful of deficiencies.

Rather than firms misinterpreting SEC regulations, in reality, the SEC's interpretation and application of its own regulations changed without proper notice and comment, resulting in regulation by enforcement. Firms like CIRA accurately disclosed 12b-1 fees and any potential, associated conflicts. Only through an extremely mechanical, overly literal and retroactive focus on certain terms (i.e. "may" versus "will") could the SEC enforcement staff find fault in the firms' disclosures.

If the SEC's intent is to eliminate 12b-1 fees or change the rules surrounding their use, the SEC should not disregard the appropriate notice and comment process. Industry participants are entitled to a meaningful opportunity to review proposed rules and provide comment, which ultimately leads to better, sound SEC rule-making and promulgates more unified compliance.

Ironically, the SEC's reliance on the use of the word "may" rather than "will" in support of its SCSDI is contrary to the instructions accompanying the SEC's new customer relationship summary (Form CRS),[2] which as drafted specifically uses the term "may:"

- Page 12, Item 3.A.(i)a
  Broker-dealers must describe their transaction-based fees. With respect to addressing conflicts of interest, a broker-dealer could, for example, include a statement that a retail investor would be charged more when there are more trades in his or her account, and that the firm ***may*** therefore have an incentive to encourage a retail investor to trade often. (Emphasis added).

- Page 12, Item 3.A.(i)b.(2)
  With respect to addressing conflicts of interest, an investment adviser that charges an asset-based fee could, for example, include a statement that the more assets there are in a retail investor's advisory account, the more a retail investor will pay in fees, and the firm ***may*** therefore have an incentive to encourage the retail investor to increase the assets in his or her account.[3] (Emphasis added).

The inconsistency represented by the SEC's use of the term "*may*" in connection with its Form CRS instructions, while simultaneously pursuing enforcement actions against firms for using precisely the same term creates an unworkable regulatory regime and denies firms necessary certainty in their compliance efforts – all of which could be avoided by simply talking to industry participants.

The SEC should not circumvent the protections afforded by a notice and comment process, especially if it relates to an effort by the SEC to eliminate or severely restrict the role of 12b-1 fees. Moreover, treating firms that attempt to comply with SEC regulations the same as those that make no effort to do so, disincentives firms to comply with SEC's regulations.

While the SCSDI resulted in an impressive remediation statistic under the guise of investor protection, it tarnished the SEC's reputation among industry participants. Specifically, the SEC's actions deny firms' consistency in terms of the SEC's interpretation and application of its own rules and regulations. The denial of such consistency makes it extremely difficult to do business.

As an example of this inconsistency, activity that the SEC reviewed and allowed for more than a decade suddenly becomes the subject of an enforcement action. It is improbable that the SEC was

[2] https://www.sec.gov/rules/final/2019/34-86032.pdf, *see also* 17 CFR 279.1

[3] https://www.sec.gov/rules/final/2019/34-86032-appendix-b.pdf

wrong for over a decade in reviewing this activity across hundreds of firms. However, even if the SEC erred, the industry should not bear sole responsibility.

CIRA's negotiations with the enforcement staff on the SCSDI exemplify the concerns outlined in this letter. CIRA asked if its current ADV disclosure language was sufficient. The SEC enforcement staff expressly declined to provide an opinion on that question and directed CIRA to consult with its compliance and legal experts. If the SEC refuses to answer such a specific, direct and relevant question, no firm can ever be certain that it is meeting its regulatory obligations.

The better approach for the SEC and the industry is for the SEC to address perceived industry-wide issues on a proactive basis, not through retroactive enforcement. In the face of activity perceived by the SEC to be problematic, the SEC should collaborate with firms to provide education, notice and the opportunity to comment. This process should be followed by sufficient time for firms to conform to the SEC's regulatory expectations. This is better for the SEC, investors and industry participants.

Independent financial firms and advisors have a reasonable expectation that the SEC will disclose clearly its rules and expectations before engaging in enforcement. Regulation by enforcement is contrary to this expectation. Further, regulation by enforcement strips firms of the requisite notice and ability to comment. This further leads to inconsistencies in interpretation and enforcement and, ultimately, increases cost for investors, while decreasing investor choice. It is a fundamental tenet of American jurisprudence that an individual or firm should not be held to violate a standard ex post facto after a new law is passed or a new interpretation accepted. Regulation by enforcement is contrary to that fundamental principle.

On the heels of the SCSDI, the SEC extended the same enforcement practices employed with respect to 12b-1 fees – the dissection of firm disclosures made in good faith based on published rules and well-known industry norms – to a wide variety of firm fees and revenue sources. For example, the SEC continues to regulate by enforcement in addressing bank sweep accounts,[4] transaction cost markups, and execution costs in connection with retail wrap fee programs.[5]

The SEC also is taking aim at firms recommending specific share classes that may not be the cheapest available by certain mutual fund companies, such as F3 shares, sometimes referred to as "clean shares" or "zero paying cusips." The SEC ignores the fact that a firm's ability to offer clean shares or zero paying cusips requires a complete restructuring of most firms' compensation models with the product companies, clearing firms, financial professionals and ultimately customers. Simply selling clean shares or zero paying cusips does not eliminate the cost of transacting business and will ultimately result in increased costs to customers.

Firms seeking to adjust their business practices and disclosures to address new regulatory expectations are forced to do so in a regulatory environment that lacks clarity and demonstrates a

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[4] Stephanie Avakian, Keynote Remarks at the 2019 SEC Regulation Outside the United States Conference (November 5, 2019) *available at*: https://www.sec.gov/news/speech/speech-avakian-2019-11-05

[5] SEC Charges Smith Morgan Stanley Smith Barney With Providing Misleading Information to Retail Clients https://www.sec.gov/news/press-release/2020-109

proclivity to use enforcement as a matter of first resort. This environment created by the SEC is contrary to the approach promoted by the current administration. Specifically, as recently as May 19, 2020, President Trump articulated the appropriate approach that the SEC should take toward its enforcement role: "The heads of all agencies shall consider whether to formulate, and make public, policies of enforcement discretion that . . . decline enforcement against persons and entities that have attempted in reasonable good faith to comply with applicable statutory and regulatory standards."[6]

Uncertainty stemming directly from regulation by enforcement provides operational uncertainty for firms making real-time, good-faith business judgments. The President's Order instructs agencies to "revise their procedures and practices" to reflect certain "principles of fairness in administrative enforcement" including that "[l]iability should be imposed only for violations of statutes or duly issued regulations, after notice and an opportunity to respond," and "[a]dministrative enforcement should be free of unfair surprise."[7]

As outlined in the Petition, the SEC's actions on 12b-1 fees are contrary to, among other things, Supreme Court rulings, the Administrative Procedure Act, and even statements by the SEC's own Chair. Further, previous staff settlements and published guidance do not hold the weight of law.[8] CIRA believes that the SEC should reconsider its approach in light of this Petition, fundamental concepts of fairness, and, most certainly, based on the President's executive order.

Thank you for the opportunity to comment in support of this Petition.

Sincerely,

Seth Miller
General Counsel
Chief Risk Officer

cc: (via email)

Securities and Exchange Commission

Honorable Jay Clayton, Chairman (chairmanoffice@sec.gov)
Honorable Allison Herren Lee, Commissioner (CommissionerLee@sec.gov)
Honorable Hester M. Peirce, Commissioner (CommissionerPeirce@sec.gov)
Honorable Elad L. Roisman, Commissioner (CommissionerRoisman@sec.gov)

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[6] Donald J. Trump, Executive Order on Regulatory Relief to Support Economic Recovery, at § 5 (May 19, 2020) *available at*: https://www.whitehouse.gov/presidential-actions/executive-order-regulatory-relief-support-economic-recovery/
[7] *Id.* at § 6
[8] Jay Clayton, Chairman, U.S. SEC, Statement Regarding SEC Staff Views (Sept. 13, 2018), https://www.sec.gov/news/public-statement/statement-clayton-091318