July 20, 2022

Ms. Tung Chan
Colorado Securities Commissioner
1560 Broadway, Suite 900
Denver, CO 80202

Re: Ongoing Financial Planning Guide

Dear Commissioner Chan:

XY Planning Network[1] ("XYPN") respectfully submits these comments to the Colorado Division of Securities (the "Division") with respect to its *Ongoing Financial Planning Guide* ("Guide" or "Guidance")*,* published in March 2022. As the Division stated in a March 23, 2022, news release, the Guide was developed to *"assist investment advisers offering ongoing financial planning services,"* and *"the staff published the guidance in response to the growing trend of advisers offering financial planning under an ongoing or continuous model, and the increasing need for advisers to review and enhance their compliance programs in this area."*[2]

XYPN agrees in concept that guidance which helps firms to comply with state regulations is a key part of the regulatory oversight process. We also agree that registered investment adviser (RIA) and financial planning fees should be transparent and fair, and that RIAs should be accountable for delivering the services promised to their clients via disclosures and in the client agreement. However, we have concerns with certain conclusory statements and business requirements contained in the Guide, especially as they pertain to the regulation of financial planning services delivered by RIAs providing "fee for service" ("FFS") billing arrangements.

The Guide describes potential problems uncovered during recent investment adviser regulatory examinations. Specifically, it describes the Division's difficulty tracking and correlating an investment adviser's financial planning fees with the financial planning services provided to clients. However, the delivery of financial planning services, and compensation for these services, is not unique to RIA models that charge only for financial planning. By applying new recordkeeping and other requirements only to advisers who charge separately or solely for financial planning, the Guidance reveals a bias in favor of the traditional assets under management ("AUM") approach and against the FFS billing arrangement, even if the client ultimately receives identical services for the same fee amount. This was done without identifying any corresponding risk presented by the FFS fee methodology.

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[1] XY Planning Network (XYPN) is the leading organization of fee-only financial advisers who specialize in providing financial planning advice to Gen X and Gen Y clients without investment minimums by operating fee-for-service businesses. XYPN offers comprehensive resources to help financial planners run better and more successful businesses serving their clients.

[2] Colorado Department of Regulations, *Division of Securities Industry Alert - The Colorado Division of Securities Provides Regulatory Guidance for Ongoing Financial Planners*, March 23, 2022.

It is unclear how pervasive these fee problems are, or the extent to which any consumer harm occurs under an FFS compensation model, which, after all, can be terminated by the client at will if a consumer is dissatisfied. A review of the Division's enforcement actions since 2020 do not show any settlements or orders involving an RIA charging excessive fees. Absent such evidence, we cannot understand the depth and scope of the problems identified by Division examiners. For example, is the concern a recordkeeping issue, a fee disclosure issue, a contract clarity issue, or a 'reasonable fee' concern? Is it a comparison of advisory services available and services rendered? How many regulatory exams uncovered issues with fees, and over what period of time were these exams performed?[3] Have similar issues been uncovered during exams of AUM advisers that also provide financial planning services? Would firm violations of fee transparency rules be better addressed through enforcement actions rather than overarching industry guidance? The Guide provides no substantiation, but rather imposes an onerous fee standard on just one particular method of compensation for financial planning services, without demonstrating the impact on either investor costs or investor well-being.

Our overall concerns with the Guidance include: (i) its application to the financial planning profession is unclear, as "ongoing financial planner" is not an industry term; (ii) it creates a disparity between the fee invoicing requirements that fee-for-service RIAs must implement and those required for investment advisers using an AUM approach, particularly where AUM investment advisers provide otherwise identical financial planning and investment management services; (iii) it limits access to financial planning services for a growing number of Colorado consumers who have not yet amassed sufficient liquid assets to be managed under the AUM model; (iv) it does not make a clear connection between its pricing and recordkeeping requirements and the benefits that accrue to the consumer; (v) it suggests that financial planners refrain from using terms such as 'holistic' and 'comprehensive' in describing their services when such terms were never proscribed for advisers charging AUM fees for similar services; and (vi) its use of a custody arrangement as a fee refund process, and its position against payment-for-availability and service-bundling arrangements, are inconsistent with existing standards that apply to AUM advisers, and unsupported in law.

Finally, given its specificity and scope, the Guidance is akin to rulemaking but without the due process afforded in rulemaking. The Division should give representatives from the public and industry an opportunity to provide input that the Division should consider before imposing such requirements as guidance.

1. Introduction

The mission of XYPN is to develop and advance the financial planning profession for the benefit of the public. As such, we support a code of professional conduct that (i) includes a robust fiduciary standard that requires the delivery of financial advice in the best interests of

[3] *See Applicability of the Investment Advisers Act to Financial Planners*, Note 9.

clients and (ii) is based upon CFP Board's[4] *Code of Ethics and Standards of Conduct*[5] ("*Code and Standards*").

It is through this fiduciary lens that our organizations consider the issue of fees for financial advice. When providing financial advice and/or financial planning services in accordance with the *Code and Standards*, our professionals must, prior to or at the time of an engagement, provide the following information, and document that this information has been provided to the client: (i) how the client pays for the products and services, (ii) a description of any additional types of costs that the client may incur, including product management fees, surrender charges, and sales loads; and (iii) how the CFP® professional, their firm, and any related party, are compensated for providing the products and services. The CFP® professional also must notify the client any time these fees are changed or updated.

We are concerned that the Guidance will prompt FFS RIAs to move to AUM billing practices, even when this fee arrangement does not align with the services they are providing to their clients, or may prove to be more expensive, and at times creates a conflict between the adviser and their client. More troubling, the Guidance has the potential to limit access to financial planning advice for those who are willing to pay an ongoing advice fee but do not yet have a portfolio of assets to manage and cannot meet the typical minimums of AUM-based advisers. This adversely and disproportionally affects people of color and moderate-income consumers who want and need planning services.

An advisory relationship is ongoing and not a transaction-based service model. Yet, it appears that the Division is pushing RIAs to charge transactionally, which is more similar to a broker-dealer sales commission model than it is to a full-service financial planning or advisory model. The more times an RIA touches their client's account or meets with the client, the more the RIA can charge them. By forcing RIAs to conform to a brokerage or transaction-based fee structure, the Guidance asks RIAs to mimic a business that is predicated on the distribution of sales and not the delivery of objective, client-centered advice. As noted earlier, the AUM model also limits access for younger or moderate-income consumers who wish to purchase and pay for an ongoing adviser engagement.

The Guidance also creates an incentive for RIAs to recommend liquidation of existing client accounts at other financial institutions and roll them over to the adviser to manage, in order to increase the account value and charge a traditional AUM fee. Alternatively, the adviser may be incentivized to take unnecessary action on an existing client account, such as unnecessary trading in a 'buy and hold' portfolio, and justify their fee by showing "activity" beyond being available to their clients as needed. This would not be in the best interest of Colorado investors.

The Guidance provides no context that would help us understand its rationale. What consumer harm has been established in light of these issues? We can say that during the most recent eight years there have been no claims regarding financial planning services filed against

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[4] CFP Board is a non-profit certification and standard-setting organization that sets competency and ethical standards for more than 93,000 Certified Financial Planner™ professionals throughout the country. CFP® professionals voluntarily agree to comply with CFP Board's rigorous standards, including education, examination, experience and ethics, and subject themselves to CFP Board's disciplinary oversight.
[5] See, https://www.cfp.net/ethics/code-of-ethics-and-standards-of-conduct.

any of XYPN's nearly 1,000 advisers covered under its errors and omissions policy (for which XYPN has direct access to E&O claims data). This excellent record – far below the claims rate of other fiduciary advice models – is a tangible indication that consumers are not being harmed by the FFS model.

2. Clarification as to How the Guidance Applies to Financial Planning Services

Although the Guidance is described as regulatory guidance, there are questions as to its applicability as well as its structure. We object to the use of the term "ongoing financial planner" because it causes confusion as to whom it applies. The term "financial planner" is an industry term that describes a professional who delivers a process that assists an individual or household in meeting lifetime financial needs, such as saving for a home, college or retirement, insurance, tax and estate planning, and so on. Developing, monitoring, and updating a financial plan based on life-changing events such as marriage, birth or adoption of a child, a new job, etc., is independent from its implementation. On the other hand, an RIA provides investment advice based on their client's short- and long-term *investment* needs. An RIA recommends which investments an individual should buy or sell, and may manage a client's portfolio on an ongoing basis.

It took the SEC and state securities regulators approximately a decade during the 1980s to determine that, because financial planners typically provide investment advice as a part of their comprehensive advisory services, they should be registered with state securities administrators and the SEC.[6] Since then, examiners from both the states and the SEC have overwhelmingly focused on firms engaging *"in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities …* "[7] Yet with the Guidance, the Division is applying a new and perplexing market conduct standard, a standard applicable to the delivery of non-investment financial planning services under a confusing label of 'ongoing financial planner.' This terminology is not commonly understood by consumers, or even among financial planning professionals.

3. Equitable Regulatory Treatment of Compensation Models

We share Colorado's investor protection concerns that fee structures should be fair and reasonably priced, given the RIA's fiduciary obligations to its clients. As such, we believe that when evaluating various fee structures, including the traditional commission or AUM models as well as fee-for-service models,[8] it is imperative that the Division consider whether fees are (i)

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[6] See, e.g., "*Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons who Provide Investment Advisory Services as an Integral Component of Other Financially Related Services"* SEC Statement of staff interpretive position, Release No. IA-770 (Aug. 13, 1981); and Rel. No. IA-1092 ("…developed jointly by [SEC] Division staff and the North American Securities Administrators Association, Inc. ("NASAA") to update Investment Advisers Release No. 770…") (Oct. 8, 1987).

[7] *Applicability of the Investment Adviser Act,* (Rel. No. 1092) at 7-8.

[8] Financial planners have charged hourly rates and retainers for decades. See, e.g., Susan M. John, panelist at an SEC Roundtable on Investment Adviser Regulatory Issues, May 23, 2000. *"In the beginning, and this is early '80s, it was fairly easy to distinguish conflicts of interest in the fee arena because the primary method of charging for services in those days was on an hourly rate or as a percentage of assets under management."* Another national financial planning network, the Garrett Planning Network, was founded in 2000 specifically to bring together the

transparent to the customer; (ii) reasonable for the services provided; and (iii) easy to terminate if a customer is dissatisfied or otherwise wishes to choose different services or service providers, all of which we contend are provided in an FFS model.

Among other factors that should be considered when determining if a fee is reasonable, the Division should take into account the financial planner's experience, whether it is a large firm offering a variety of other professional services such as tax preparation or complex estate planning strategies, the individual adviser's educational qualifications, whether client portfolios are outsourced for professional management, the complexity of the client's financial goals and objectives, and the amount of client assets available to achieve those goals and objectives. None of these factors are considered in the Guidance.

Moreover, the factors we cite are not all-inclusive, and should not be applied equally to all compensation arrangements used for providing financial planning services. As such, we are concerned that Colorado is establishing guidance that imposes more stringent requirements on FFS advisers, relative to AUM advisers offering the same services, without a need to do so. As a regulatory principle, any requirements applicable to financial planning should apply equally to FFS and AUM advisers. If a regulatory requirement or guidance does not apply to financial planning delivered under AUM compensation arrangements, it should not apply to financial planning delivered under FFS compensation structures.

For example, an FFS planner charging a $3,000 annual fee (or $250/month) for financial planning and investment management services for a client with $300,000 in investable assets should not be subject to different recordkeeping requirements than an AUM planner charging a 1% AUM fee, for the same $300,000 client, to generate the same $3,000 annual fee, for the same services.[9] Imposing an AUM-fee model as the RIA industry standard is arbitrary, and conflicts with the marketplace and consumer preferences. Yet, the Division's Guidance does not follow this basic parity principle.

As the profession has evolved from a simple asset management service to more sophisticated financial planning, advisers have found that fixed, monthly, or hourly fees may more appropriately align with the types of services they are providing and the clients they are serving. Accordingly, as advisers provide value to their clients beyond asset management, they will continue to migrate to a compensation model other than AUM in order to align the fees they charge with the services they provide. However, under the Guidance, Colorado-based FFS providers are now required to create itemized invoices for services provided, even though this is not, and has never been, required for AUM advisers providing identical services.

Whether fees for service are reasonable depends on the adviser's background, the client's needs, and the services provided. Exposing a fee model to heightened scrutiny because it fails to conform to a historical pricing practice designed for wealthy investors, is unreasonable. According to an August 9, 2021, *Wall Street Journal* article, *"[i]n the end, how consumers*

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existing RIAs charging hourly for advisory services; and the Alliance of Comprehensive Planners (previously the Alliance of Cambridge Advisors) that was training advisors utilizing the annual retainer model for financial planning services.

[9] The subscription fee would be $250 a month for financial planning services, or the equivalent of a 1% annual AUM fee (.01 X $300,000 = $3,000 divided by 12 months = $250).

choose to pay for financial advice has big implications. Cerulli Associates estimates that up to $70 trillion in wealth will be transferred over the next 25 years to heirs and charity. Much of it will go to the same younger generation that is embracing newer options—including advisers who charge flat annual or monthly fees and robo advisers that manage portfolios with computer algorithms."[10]

Additionally, if it is the Division's position that RIAs now are not adequately disclosing their compensation structures, it is the Division that must be clear on how the RIA firm is to disclose its fee formulas to clients. If the Division intends to issue deficiency letters to RIAs on the lack of fee disclosure, it should, at a minimum, explain the factors it will use to determine whether a disclosure is deficient. To satisfy this requirement, the Division's Guidance on fee-for-service models cannot require more detailed disclosures about planning services and their associated fees than is already required for similar services provided under an AUM model.

4. AUM Model Limits Access for Investors with Fewer Assets

Due to minimum investment thresholds, the AUM model regrettably pushes financial planning and investment advisory services out of reach for most Coloradans. It is suitable only for clients who have accumulated significant liquid assets and who are willing to delegate trading authority to their adviser. Under this scenario, a wealthy client can obtain bundled financial planning services in addition to portfolio management services. According to a Cerulli report on investment adviser trends, *"Under a traditional asset-based-fee model, advisors are typically handcuffed by asset minimums, leaving them unable to work with younger investors because they would not be profitable engagements. By implementing non-traditional fees into their pricing, RIAs can readily engage with these investors without waiting for them to reach an asset threshold."*[11]

In contrast to wealth management firms that require advisory accounts to have significant financial assets, the financial planning profession looks for ways to provide financial planning services broadly in the communities they serve. This includes providing these services to consumers with little or no investable assets, to help them on the road to a sound financial future. Since these consumers may not be candidates for an AUM fee structure, an FFS arrangement makes much more sense. To make investment management and financial planning services accessible to more of its citizens, the Division should exercise caution when discouraging FFS relationships, especially when the recent growth of the model suggests that in practice Coloradans are readily engaging with FFS business models.

5. 'Holistic' and 'Comprehensive' Descriptors Should be Permitted

According to the Guidance, Division Examination Staff was unsatisfied with the inability of RIAs to produce documentation verifying the work performed on behalf of their clients and did not like general marketing terms used to describe their services, such as 'holistic', 'comprehensive', or 'well-being'. We would note that, while NASAA's model rule prohibiting unethical business practices includes "misrepresenting the nature of the advisory services being

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[10] Appeared in the August 9, 2021, print edition as *'Say Goodbye To the 1% Adviser Fee?'* Copyright © 2021 Dow Jones & Company, Inc. All Rights Reserved.

[11] The Cerulli Report *U.S. RIA Marketplace 2021, Meeting the Demand for Advice.*

offered or fees to be charged for such service,"[12] it is *not* a misrepresentation, in our view, to advertise that these services are available and actually provided to the client. Given the adviser's fiduciary obligation, these statements should be allowed. As with other examination issues, some of these regulatory concerns could be addressed by noting deficiencies in documentation, and encouraging best practices with regularly updated FAQs that help the advisory community adopt more detailed firm and client documentation. These FAQs could also address any disclosure gaps, or additional required disclosures necessary to help clients better understand their available fee options.

As required by CFP Board's *Code and Standards*, certificants must accurately define the scope of services in the client agreement. If an RIA is providing services other than investment management, they should be allowed to tell their clients that they do so. If an RIA is also a financial planner, the terms 'holistic', 'comprehensive', and 'well-being' are accurate and appropriate descriptors of the services they provide. Moreover, these terms are commonly used when a firm provides comprehensive financial planning services under the AUM model, as represented by numerous state registrants and notice-filed firms, including those containing those descriptive terms in the firm's name.

Finally, the Guidance's apparent restriction on terms that generally describe the scope of services offered raises the fundamental question of whether such a restriction would have a chilling effect on a business's First Amendment right to freedom of commercial speech. Specifically, we encourage the Division to carefully review the Supreme Court decision in *Ibanez v. Florida Dept. of Business and Professional Regulation*, 512 U.S. 136 (1994) in which the Court held that Ibañez's use of the CFP® designation qualifies as 'commercial speech' and would only ban such speech if it is false, deceptive, or misleading. Similar to the use of a professional designation that is descriptive of the services provided (i.e., financial planning), the Guidance is in conflict with the Court's opinion that *"If it is not (false, etc.) the State can restrict it, but only upon a showing that the restriction directly and materially advances a substantial state interest in a manner no more extensive than necessary to serve that interest."*[13] As noted previously, the Division has failed to show evidence of the type of harm that would require such a draconian prohibition on commercial speech.

6. 'Availability' Should Be Permitted

The Division's Guidance states that 'availability' is not a service. If an adviser agreement or disclosure states that the adviser will meet with clients regularly, and the meetings do not occur, the fee must be refunded. However, AUM firms historically have, and continue to charge and earn the same quarterly fee payments during times of high utilization (e.g. increased trading activity or more client meetings) as in quarters with low or no service utilization (e.g. basic portfolio quarterly rebalancing and no client meetings), without any obligation to refund fees in quarters where the firm's availability is unused. AUM firms routinely highlight 'being available to talk you off the ledge in a bear market' as a valuable service, which many Coloradans needed in the early months of the Covid crisis and is occurring today amidst current market volatility. Yet, the Division has never required AUM providers to refund fees in 'bull market' years, when there

[12] "NASAA Unethical Business Practices of Investment Advisers, Investment Adviser Representatives, and Federal Covered Advisers, Model Rule 102(a)(4)-1," (as amended), subsection (g).

[13] *Ibañez v. Fla. Dept. of Business and Professional Regulation, Bd. Of Accountancy, 512 U.S. 136 (1994),* Syllabus.

is no bear market to discuss, resulting in fewer client meetings or market transactions separate from periodic rebalancing.

Nowhere in Colorado's fee rule is payment for availability deemed a breach of fiduciary conduct (thus, ostensibly, why it has long been permitted for AUM firms). Yet, the Guidance states that "Fees should only be charged for work that has been or will be completed."[14] This position is unfounded. It conflicts with long-standing industry practices under the AUM model, and renders most fee structures in the industry a commercial arms-length transaction, instead of the fiduciary standard in which clients place their trust and confidence in the adviser. That a fee covering availability violates the unreasonable fee rule, as written, is unsupported.

In contrast, recent interpretative guidance by the SEC describes the investment adviser's fiduciary duty as requiring the adviser *"to adopt the principal's goals, objectives, or ends."*[15] The Commission's guidance, which we presume would not differ materially from the duty of care for state-registered RIAs, goes on to explain, *"In particular, the specific obligations that flow from the adviser's fiduciary duty depend upon what functions the adviser, as agent, has agreed to assume for the client, its principal."*[16] As a best practice, the Division should encourage an RIA's 'functions' to be disclosed in the client agreement, including the client's expectations for the adviser's availability. By requiring such disclosures, Division Examination Staff should have an easier time confirming if an RIA has breached their duty of care, either through the exam or a client complaint.

7. No Clear Connection to Investor Harm

The Guidance purportedly is designed to create investor equity, but it makes no connection between the FFS model and investor harm. We would expect to see this connection carefully drawn using data collected during firm examinations, and available data that benchmarks fees in the investment management and financial planning professions. It is not sufficient that examination staff was unable to match a fee to a specific service provided, because fees are derived from any number of services, and established based on multiple factors in the relationship.

A wide range of fee models can be good proxies for the scope and complexity of an adviser-client relationship, whether it is based on AUM, an hourly rate, a subscription fee, or some other compensation arrangement. There are any number of reasons why an adviser and client choose a particular fee model, including the simplicity or complexity of the client's financial profile, the range of services provided, and the accessibility of the adviser to the client.

Traditionally, advisers have used the client assets they managed (the AUM model) as a basis for the fees they charge, even though, as mentioned earlier, the AUM model is a crude proxy for scope of services or relationship complexity. For example, a client with $5 million in assets to manage does not necessarily, in practice, take 10X the time or require 10X the analysis to develop a financial plan or investment recommendation, compared to a client with

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[14] *Guidance*, at 5.

[15] *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, SEC, at 8. (Effective July 12, 2019.)

[16] *Commission Interpretation*, at 10.

$500,000 in assets. Yet, AUM advisers effectively charge the $5 million client 10X more than the 'smaller' client by virtue of a flat 1% AUM portfolio fee. However, if a FFS advisor offered a similar model with 10X the annual fee, the Division would effectively require a demonstration of 10X the work, even if the consumer was otherwise content with the arrangement (as they have already shown they are in the case of an AUM advisor).

This distinction is especially concerning because, in practice, financial planners using FFS pricing arguably have even more clearly aligned fee schedules to the scope of services and needs of their clients. While the AUM model typically only incorporates a single factor: the amount of investable assets, FFS advisor pricing differences can be established based on the following factors (not all-inclusive): (i) the scope of financial planning services to be provided, (ii) the scope and frequency of portfolio monitoring services; (iii) the complexity of household finances; and (iv) the experience and qualifications of the financial planner. These factors can vary for each adviser/client relationship, and are based on the client's overall financial goals and objectives. Accordingly, the adviser and client should be able to discuss these factors, the client's expectations for the relationship, and enter into a fair and equitable contract for needed services.

The Division has provided no factual data or findings from its examination staff to suggest that investors are harmed under an FFS model. In contrast, based on publicly available reports from NASAA, we know that the most significant examination RIA deficiencies have been registration issues, followed by books and records, and then contracts. According to a recent NASAA report,[17] fees rank sixth in terms of examination deficiencies. Of the fee discrepancies, 36% of firms had a mismatch between their fee contracts and their ADV forms, 10.72% of firms had at least one miscalculated fee, and 10.02% had other asset management fee issues or concerns. The Guidance issued by the Division focuses on a tiny percentage of issues identified in these reports.

Many of the issues NASAA uncovered, such as miscalculated AUM fees, or applying the wrong fee schedule to the client's managed account, have nothing to do with the FFS model. According to Cerulli, a growing number of consumers (20%) prefer a retainer fee. At the same time 31% of RIAs charge financial planning fees, 13% charge retainer fees, and 10% charge hourly. These data imply that consumer demand for FFS retainers (at 20% of consumers) is higher than the current supply of RIAs offering that option (only 13% of advisers). Consequently, the growth of the FFS model is likely to increase over time.[18]

Furthermore, FFS arrangements, especially the monthly subscription model, can be especially investor-friendly, because it is easy for an investor to terminate an FFS relationship at will. The FFS client can avoid transferring account assets to a new financial institution, or liquidating assets held by one custodian in order to change advisers, which is a common issue under the AUM model. Under standard industry invoicing requirements, investors are reminded of their ability to terminate when they want to. If regulators are concerned about consumer protections under a subscription model, they can require that consumers continue to be able to

[17] NASAA 2021 Investment Adviser Coordinated Exams.

[18] Cerulli, The Price of Advice, April 2021, at 2, 4. Available at https://info.cerulli.com/rs/960-BBE-213/images/2021-The-Price-of-Advice.pdf.

easily cancel investment management services, rather than limiting the availability of an FFS model in the first place.

8. Bundling, Custody, and Refunds

Colorado's Guidance strongly discourages bundling of investment management alongside a standalone financial planning fee and suggests that firms offering comprehensive advice should review their client's fees to determine if they are reasonable given the services they are providing. However, it is longstanding, common practice for AUM firms to bundle substantively identical financial planning services within a standalone AUM fee. NASAA's annual report for 2021 shows that of 17,454 state-registered investment advisers, 64% (11,342) offer portfolio management services and 65% (14,740) offer financial planning services. With respect to fees, 84% (14,886) of state-registered firms charge assets under management fees, reflecting a convergence of both portfolio management and financial planning services being rendered for a (bundled) AUM fee.[19]

In addition, in a given year, when an AUM firm with bundled financial planning has a client who has no financial planning issues (including meetings or non-investment deliverables), Colorado has never required an AUM firm to unbundle its AUM fee, nor required all AUM providers to refund the financial planning or other portions of their fees. Similarly, if an AUM firm states that it will meet periodically with clients for portfolio reviews, but does not conduct (or cannot document) that a client review occurred within the quarter, there is no requirement that a fee be refunded. And if the firm commits to only a single annual meeting for the year, there is no obligation to refund any portion of the AUM fee paid for the 'annual service' even if the client meeting does not occur within a 6-month period. In contrast, under the Guidance, FFS firms are discouraged from bundling services under a single fee because of regulatory concerns that such firms must show evidence of either activity in the account, an updated financial plan, or a client meeting where other deliverables were provided, before the firm can collect a fee.

Yet in practice, bundling of services has a positive impact on consumers and can give them greater control over the relationship. In addition, firms that bundle services can charge a lower fee than those charging *a la carte* services at a higher rate. As long as the scope of bundled services can be clearly explained and disclosed, clients are able to decide for themselves whether to pay for the bundle of services or not, and terminate the relationship in the event they are not satisfied with the outcome. This flexibility also gives the financial planner the ability to serve clients in different income and asset brackets, with different financial needs.

Ultimately, consumers should be able to select the type of fee model that is best for them, including when bundled services may be preferred or cost effective – as has long been common within the AUM model already – as long as the fee and services provided are clearly disclosed, and more importantly, as long as the relationship can be easily terminated by the consumer. This is a requirement that ongoing (often monthly-billed) FFS models currently meet, arguably in a manner that is more effective than quarterly AUM fees.

[19] *See* "Investment Adviser Section Annual Report," April 2021. Available at [2021-IA-Section-Report-FINAL.pdf (nasaa.org)](2021-IA-Section-Report-FINAL.pdf).

Regarding refunds, we are also concerned that the Division's Guidance seems to recognize and yet also ignore that, if the term of the agreement is a whole year, the adviser has a year in which to provide the services. According to the Guide, again a set of recommendations or "best practices", instructs an RIA who bills in advance that "those unearned fees *must be* refunded, or otherwise consumed by the end of the second quarter following receipt of payment." While we recognize that charging more than $500 more than 6 months in advance may trigger custody – for which the Division aptly notes that advisors can and should "make a good faith determination that approximately half of the deliverables they have contracted to perform [be] completed by mid-year" – the Division's position that an adviser has an obligation to refund fees if a half year's worth of services have not been rendered, even if the client themselves has not terminated the engagement, instead of the adviser simply accepting that they may have custody for exceeding $500 in billing more than 6 months in advance, appears to extend the limitations of the custody rule beyond its scope.

9. Guide Requirements Should Have Been Subject to Rulemaking

We recognize that not all statements made by a regulatory agency are significant enough to warrant the rulemaking process. Guidance is a form of nonbinding policy that does not have legislative or judicial force, but legislative rules do. The Supreme Court, citing a D.C. Circuit Court decision, has defined a legislative rule as "[a]n agency action that purports to impose legally binding obligations or prohibitions on regulated parties."[20] If an administrative agency's guidance appears on its face to be binding, rather than a simple policy statement, and if the agency applies the guidance as if it were binding, then it becomes a legislative rule, and must go through the rulemaking process prescribed by the applicable Administrative Procedure Act.[21] For reasons highlighted below, we believe that the Guide is not non-binding guidance, it is a legislative rule that should undergo the rulemaking process before it is enforced.

First, the Guide's disclaimers beginning on page 1 state that it is a best practices publication related to emerging concerns. The Guide's footnotes indicate that it isn't binding, is informational only, doesn't represent legal advice, and doesn't supersede any laws or rules. However, these disclaimers are problematic, because the Guide fails to explain why these are best practices or how the fee requirements help RIA firms comply with Colorado securities laws. Additionally, the service and fee itemization requirements, such as using the custody process to return "unused" fees, are specific enough to constitute unpromulgated rulemaking, and directly

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[20] *Perez v. Mortgage Bankers Ass'n,* 135 S. Ct. 1199, 1203 (2015) ("The United States Court of Appeals for the D.C. Circuit has defined a legislative rule as "[a]n agency action that purports to impose legally binding obligations or prohibitions on regulated parties" and an interpretative rule as "[a]n agency action that merely interprets a prior statute or regulation, and does not itself purport to impose new obligations or prohibitions or requirements on regulated parties."); *see National Mining Ass'n v McCarthy*, 758 F.3d 251 (D.C. Cir 2014) ("An agency action that purports to impose legally binding obligations or prohibitions on regulated parties – and that would be the basis for an enforcement action for violations of these obligations or requirements -- is a legislative rule. An agency action that sets forth legally binding requirements for a private party to obtain a permit or license is a legislative rule. (As to interpretive rules, an agency action that merely interprets a prior statute or regulation, and does not itself purport to impose new obligations or prohibitions or requirements on regulated parties, is an interpretive rule.)"

[21] "The Colorado Administrative Procedure Act, C.R.S. Title 24, Article 4. "The general assembly finds that an agency should not regulate or restrict the freedom of any person to conduct his or her affairs, use his or her property, or deal with others on mutually agreeable terms unless it finds, after a full consideration of the effects of the agency action, that the action would benefit the public interest and encourage the benefits of a free enterprise system for the citizens of this state…"

implies that advisers who do not comply with the Guidance will be declined in their initial registration process or be issued deficiency letters upon examination. Accordingly, this Guidance imposes a firm regulatory interpretation of Colorado statutes, and as such should go through the rulemaking process.

In its Guidance, the Division is requiring a change in the investment advice business model itself, rather than issuing regulatory policy, when it reads: "*The Staff would like to work with advisers to assist them in developing a business model that better meets clients' need and complies with existing regulation."* We contend that it is out of the purview and expertise of a governmental agency to opine on optimal business models for complying with legislative rules because industry participants vary, as do their operating processes, products, services provided, and the client base served.

Alternatively, informally "working with the industry," rather than using the rulemaking process, could potentially lead to the Division privately entertaining the views of some industry participants but not others, resulting in an unfair policy, or one that may be unworkable on some business platforms. The due process rights afforded registrants in rulemaking are not provided in informal guidance. If the Division is truly interested in discussing fee models with the industry, it is our position that the only path for doing so is by the rulemaking process. The Colorado Administrative Procedure Act protects a registrant's right to raise objections and concerns in a public manner. This way, the Division follows the law by ensuring all interested parties are afforded input prior to industry mandates disguised as guidance.

As a consequence, the Division, through this Guide, exceeds its authority (i) by imposing different standards on FFS RIAs versus AUM RIAs, and thereby turns an advisory service model into a transaction-based model, and (ii) by interfering with an investor's right to enter into a business contract freely. Rather than establishing restrictive business practices, the Division should apply the existing principles-based approach provided in its unethical business practice rule, to advisory fees. Firms should be encouraged to build business models that embrace these principles, to address any excessive fee situation, especially given the rising demand of Coloradans to engage in new FFS models, and the lack of any data to indicate that Coloradans are being harmed by FFS providers.

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We appreciate the opportunity to provide these comments to the Colorado Securities Division in response to the Division's invitation to submit feedback by email.[22] We are happy to discuss these comments with you further, and to address any follow-up questions that you or your staff may have. Please contact Michael Kitces by email at michael@xyplanningnetwork.com, if you have questions or would like more information.

Regards,

Michael E. Kitces, MSFS, MTAX, CFP, CLU, ChFC
Executive Chairman, Co-Founder
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[22] *Guidance*, at 7.