**Attorneys General of New York, California, Connecticut, Delaware, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Mexico, Oregon, Pennsylvania, Rhode Island, Vermont, Washington, and the District of Columbia**

August 7, 2018

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549-1090

Re: Regulation Best Interest, Exchange Act Release No. 34-83062, SEC File No. S7-07-18

Dear Mr. Fields:

The Attorneys General of New York, California, Connecticut, Delaware, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Mexico, Oregon, Pennsylvania, Rhode Island, Vermont, Washington, and the District of Columbia write to express our concerns with respect to the proposed Regulation Best Interest, Exchange Act Release No. 34-83062, 83 Fed. Reg. 21574 (proposed May 9, 2018) ("Regulation BI" or "the Proposed Rule").

In the wake of the 2008 financial crisis, Congress recognized the need to ensure that retail investors can readily access unbiased advice from all financial professionals, regardless of whether that advice comes from an investment adviser or broker-dealer. To that end, Congress enacted Section 913 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (the "Dodd-Frank Act").

Section 913 required the Securities and Exchange Commission ("SEC") to conduct a study to evaluate: (1) the effectiveness of existing regulations regarding the standards of care owed to retail investors; and (2) the existence of any gaps in the existing regulatory structure. *See* Dodd-Frank Act, Section 913(b). It also empowered the SEC to "commence a rulemaking, as necessary or appropriate in the public interest and for the protection of retail customers . . . to address the legal or regulatory standards of care for brokers, dealers" and others. Dodd-Frank Act, Section 913(f). It specifically authorized the adoption of a best interest standard of care, while directing that this standard "be no less stringent than the standard applicable" to investment advisers, who are subject to a fiduciary standard. Dodd-Frank Act, Section 913(g)(2).

In January 2011, the SEC released its *Study on Investment Advisers and Broker-Dealers* ("the 913 Study").[1] The findings of that study were clear: the SEC Staff recommended that the SEC "establish[] a uniform fiduciary standard for investment advisers and broker-dealers when providing investment advice about securities to retail customers that is consistent with the standard that currently

1 Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011), *available at* https://www.sec.gov/news/studies/2011/913studyfinal.pdf (last visited July 29, 2018).

applies to investment advisers."[2] 913 Study at ii. The imposition of a uniform fiduciary standard for all retail investors, whether investing with a broker-dealer or an investment adviser, protects retail investors against the abuses that can result when financial professionals place their own interests above those of their customers.

The 913 Study's fiduciary obligation recommendation is grounded in the reality that most American workers do not have access to a defined benefit plan.[3] Instead, they are personally responsible for planning their financial future. In an ever more complex financial marketplace, retail investors depend on financial professionals to help guide them through a myriad of options. Indeed, at the time of the 913 Study, investment advisers registered with the SEC managed over $38 trillion in assets for over 14 million clients and FINRA-registered broker-dealers held over 109 million retail and institutional accounts. 913 Study at iii. While the investment advisers are subject to a fiduciary duty, millions more retail investors rely on FINRA-registered broker-dealers, who are not currently subject to a fiduciary duty. It is thus critical that retail investors be able to readily access unbiased advice from all financial professionals with respect to their investment decisions.

Rather than following Congress' directive, or the SEC's own well-founded recommendations from the 913 Study, the SEC has instead proposed an inadequate, watered-down standard of care in the Proposed Rule. There is much more that the SEC can and must do to protect and educate retail investors who invest in a complex marketplace. Limitations in this proposed regulation mean that many of the core issues facing retail investors are not adequately addressed. In addition, the Proposed Rule may cause new problems and add confusion for market participants, particularly retail investors who expect financial advisors to act like fiduciaries. Regulators like the States Attorneys General will bear the responsibility of protecting investors in this new regulatory environment. Any final rule that results from this rulemaking must ensure that every financial professional who works with retail customers provides them with a rigorous, comprehensive, and consistent duty of care and loyalty. We therefore write to offer comment on how the Proposed Rule can be improved to better protect investors.

## I. <u>Executive Summary</u>

The Proposed Rule falls far short in four key respects: (1) it does not impose the standard of care that the SEC itself concluded was appropriate and that investors expect; (2) it fails to adequately address conflicts, instead largely leaving the issue to broker-dealer discretion; (3) while disclosure is a critical

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2 The Department of Labor has similarly concluded that financial professionals who provide investment advice with respect to Employee Retirement Income Security Act of 1974 ("ERISA") plans or IRA accounts should be considered "fiduciaries," and therefore subject to the DOL's own Fiduciary Rule. Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 FR 20946-01. The Fiduciary Rule offered retail customers more extensive protections than does the Proposed Rule and was supported by many States Attorneys General and other investor advocates. Nevertheless, in March 2018, the Fifth Circuit Court of Appeals vacated the Fiduciary Rule in its decision in *Chamber of Commerce of the U.S.A. v. U.S. Dep't of Labor*, 885 F.3d 360 (5th Cir. 2018).

3 According to March 2017 statistics published by the U.S. Bureau of Labor Statistics, only 28% of all civilian workers had access to a defined benefit plan. U.S. Bureau of Labor Statistics, *NCS: Employee Benefits in the U.S., March 2017,* (Mar. 2017), *available at* https://www.bls.gov/ncs/ebs/benefits/2017/ownership/civilian/table02a.htm (last visited July 29, 2018) (defining "civilian workers" as including "all private industry and State and local government workers").

component of a regulatory scheme, the Proposed Rule places far too great an emphasis and reliance on disclosure; and (4) the Proposed Rule contains significant ambiguity that is likely to lead to marketplace confusion that negatively impacts both investors and the securities industry. To ensure that investors are adequately protected, it is critical that the Proposed Rule be modified in the following ways:

1. *Standard of Care Requirements:* The Proposed Rule must be changed to impose a uniform fiduciary standard applicable to both investment advisers and broker-dealers as originally recommended by the 913 Study.

2. *Conflicts of Interest Requirements:* The Proposed Rule must be modified to: (a) require the elimination of certain conflicted compensation incentives that cannot be sufficiently mitigated and to base any differential compensation to individuals on neutral factors; (b) require clear and easily understood disclosure of material conflicts of interest in principal trading for broker-dealers, akin to that which is currently required of investment advisers; (c) require the identification, disclosure, and mitigation or alternatively, elimination of all other material conflicts of interest; and (d) mandate strict enforcement of the conflict of interest rules, beyond the existing SEC and SRO supervisory regulations.

3. *Disclosure:* To the extent the Proposed Rule incorporates disclosure requirements, all disclosures must be in plain language and easily understood by investors. Investors' written contracts must also include language affirming the investor rights guaranteed by the Proposed Rule.

4. *Clarity*: The Proposed Rule must be modified to clearly define all key terms to promote clarity and uniformity.

These changes can be made without compromising investor access to financial professionals, the availability of diverse financial products, or choice in fee arrangements.

## II. Analysis of the Proposed Rule

Below, we detail each of the four areas in which the Proposed Rule falls short.

### A. The Best Interest Standard Falls Short of the Standard that the SEC Itself Recognizes Is Appropriate and that Investors Expect

Rather than establish a fiduciary standard, the Proposed Rule sets out a weak "best interest" standard. Despite purporting to require that broker-dealers act in the best interest of their retail customers, the standard adopted by the SEC does not impose a fiduciary obligation to do so. The decision to adopt a lesser "best interest" standard is in conflict with the SEC's own findings and investor expectations that a fiduciary duty is warranted.

First, the SEC itself previously determined that a fiduciary standard was appropriate. As discussed above, in 2011, the SEC staff recommended that the SEC "establish[] a uniform fiduciary standard for investment advisers and broker-dealers when providing investment advice about securities to retail customers that is consistent with the standard that currently applies to investment advisers." 913 Study at ii.

Second, retail investors expect and incorrectly believe that their financial advisers are acting in a fiduciary type relationship of trust. According to the 913 Study, investors expect "that they should not have to parse the title on a business card or other information to assess whether the professional has their best interests at heart." 913 Study at 107. The 913 Study pointed to studies showing that retail investors could not easily differentiate between investment advisers and broker-dealers and did not understand the disparate standards of conduct imposed on each. *Id.*[4] Moreover, the overall confusion between the roles of investment advisers and broker-dealers is exacerbated by the fact that, according to the SEC, 68% of customer accounts were held at firms that were dually-registered as broker-dealers and investment advisers as of December 2017. Regulation BI Release No. 34-83062, at 226. Dual registration raises the risk that customers will be further confused in situations where financial professionals may be acting in different capacities for the same customer.

That confusion is heightened further still by the financial industry's regular use of titles like financial advisor, financial consultant, and advisor that connote a fiduciary type of relationship. An analysis of broker-dealer marketing performed in 2015 by the Public Investors Arbitration Bar Association ("PIABA") concluded that broker-dealers advertise "that they offer unconflicted, trustworthy advice," and then disclaim that position when arbitrating customer disputes. PIABA Report at 8.[5] The Proposed Rule itself acknowledges this issue (although without fully addressing it). The accompanying proposed Form CRS requires broker-dealers and investment advisers to provide a relationship summary to investors and limits the ability of brokers to use the title "adviser" or "advisor." Regulation BI Release No. 34-83062, at 11, n.8; Form CRS Relationship Summary, Release No. 34-83063.

Thus, despite the SEC's own findings in the 913 Study, and clear investor expectation of a fiduciary relationship, the Proposed Rule fails to require a fiduciary duty. The Proposed Rule offers no rationale for this departure, which leaves investors exposed to the same confusion that led Congress to enact Section 913.

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4 For example, the 913 Study cited a study commissioned by the SEC and conducted by RAND Institute for Civil Justice in 2008. The RAND study, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*, found that "[i]nvestors had difficulty distinguishing among industry professionals and perceiving the web of relationships among service providers." Executive Summary, RAND Study, at xix. Likewise, in 2010, researchers at Infogroup/ORC conducted a national opinion survey and found: "Most Americans are confused about which financial professionals are required to operate under a 'fiduciary standard' that requires the financial professional to put their client's interest ahead of their own. At the same time, nearly all U.S. investors believe that all financial professionals providing investment advice should be required to operate under this pro-investor standard." Infogroup/ORC, Executive Summary, *U.S. Investors and the Fiduciary Standard*, September 15, 2010, at 3, https://www.cfp.net/docs/public-policy/us_investors_opinion_survey_2010-09-16.pdf?sfvrsn=2 (last visited June 4, 2018). Indeed, 76% of the investors surveyed believed that financial professionals termed as "financial advisors" were held to a fiduciary standard, roughly the same as investment advisers. *Id.* at 5.

5 Joseph C. Peiffer & Christine Lazaro, *Major Investor Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of a Fiduciary Duty,* PIABA, Mar. 25, 2015. Examples cited in the PIABA analysis include: (1) an advertisement by UBS that begins: "Until my client *knows* she comes first;" (2) a Merrill Lynch advertisement that states "[i]t's time for a financial strategy that puts your needs and priorities front and center;" and (3) a Wells Fargo ad that claims that "[a] healthy relationship with your Financial Advisor should make you feel that your best interests are the top priority, no matter what is happening in the market and no matter the size of your portfolio." PIABA Report at 9-14.

### B. The Proposed Rule Fails to Adequately Address Conflicts

The Proposed Rule requires that: (1) broker-dealers establish, maintain, and enforce written policies and procedures reasonably designed to identify and disclose, or eliminate all material conflicts of interest that are associated with a recommendation; and (2) broker-dealers establish, maintain, and enforce written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendation.

This proposed scheme suffers from several critical flaws. First, the Proposed Rule fails to simply ban the most pernicious practices. In fact, the Proposed Rule recognizes and describes certain conflicted compensation incentives that may not be readily mitigated. These include:

- "compensation thresholds that disproportionately increase compensation through incremental increases in sales;"
- "compensation incentives for employees to favor one type of product over another;"
- "compensation incentives within comparable product lines;" and
- "sales contests, trips, prizes, and other similar bonuses that are based on sales of certain securities or accumulation of assets under management." Regulation BI Release No. 34-83062, at 174-84.

Rather than prohibit these practices outright, the Proposed Rule instead relies on the good faith of broker-dealers to fashion effective policies and procedures. The 913 Study, however, contemplates that there may be certain conflicted practices that disclosure alone would not cure, thus warranting the application of a uniform fiduciary standard.[6] Thus, there is no good reason to permit these practices, and the Proposed Rule provides no justification for this approach.

Second, with the exception of a possible SEC or FINRA review of the required firm maintenance and enforcement of written supervisory procedures in a regulatory examination, the Proposed Rule provides no real mechanism for enforcement, especially by the retail investor. The Proposed Rule does not provide an aggrieved customer with a private of action to recover losses attributable to conflicted advice. Regulation BI Release No. 34-83062, at 42. Aggrieved customers who have been harmed by conflicted advice must instead resort to industry arbitration at which their ability to obtain and collect on

6 The 913 Study at 117 ("The uniform fiduciary standard, because it must be 'no less stringent than' Advisers Act Sections 206(1) and 206(2), would ensure that the basic protections regarding conflicts of interest currently available under the Advisers Act would be preserved and would not be watered down. The Staff believes that it is the firm's responsibility—not the customers'—to reasonably ensure that any material conflicts of interest are fully, fairly and clearly disclosed so that investors may fully understand them. To this end, however, the Commission could consider whether rulemaking would be appropriate to prohibit certain conflicts, or where it might be appropriate to impose specific disclosure and consent requirements (e.g., in writing and in a specific format, and at a specific time) in order to better assure that retail customers were fully informed and can understand any material conflicts.")

an award is potentially reduced, especially when rendered against a smaller firm.[7]

Third, broker-dealers themselves may have difficulty understanding the nature of their obligations. For instance, the Proposed Rule allows the broker-dealer to exercise its own judgment in determining whether a conflict need be mitigated or eliminated, and to write policies and procedures to address these issues. The Proposed Rule, however, leaves up to "facts and circumstances" the determination of whether those policies and procedures (and their enforcement) are adequate. Regulation BI at 167-68. Given the lack of detail in the Proposed Rule, broker-dealers may have difficulty determining whether material conflicts are (1) "associated with recommendations" and therefore subject to disclosure or elimination; or (2) "arising from financial incentives associated with such recommendations" and therefore subject to disclosure and mitigation, or elimination. This ambiguity, while designed to give maximum flexibility to broker-dealers, may in fact result in inconsistent application of the Proposed Rule nationwide and further add to the existing confusion.

### C. The Proposed Rule's Regulatory Scheme Is Too Heavily Focused on Disclosures

Instead of imposing a fiduciary duty and prohibiting the most harmful conflicts, the Proposed Rule leans heavily on disclosure. It contemplates broker-dealer disclosure of the material facts relating to the scope and terms of the relationship prior to any transaction. It also explicitly requires that the broker-dealer, prior to or at the time of a recommendation, reasonably disclose all material conflicts of interest in writing. In conjunction with the Proposed Rule, Proposed Form CRS proposes that broker-dealers and investment advisers provide the customer with a Customer Relationship Summary that, among other things, spells out the differences between brokers and investment advisers. As discussed below, while comprehensive disclosure is a key element of effective investor protection, it is no panacea.

First, studies conducted in the areas of behavioral economics, behavioral decision theory, cognitive psychology, and others have demonstrated why disclosures alone are ineffective in protecting investors. *See*, Robert A. Prentice, *Moral Equilibrium: Stock Brokers and the Limits of Disclosure*, 2011 Wis. L. Rev. 1059, 1065-1068 (2011); Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. Pa. L. Rev. 647 (2010).[8] These reasons include a failure to understand the disclosures, inadequate time to read and process the information, reliance on a trusted broker's oral representations over written disclosures, cognitive dissonance, overload effects, and other similar cognitive and behavioral phenomena. *See*, Prentice, *Moral Equilibrium,* at 1068-84; Ben-Shahar & Schneider, *The Failure of Mandated Disclosure,* at 723. These studies are consistent with findings made by the Department of Labor in connection with its own Fiduciary Rule. The Department of Labor

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7 *See Discussion Paper -- FINRA Perspectives on Customer Recovery* (Feb. 8, 2018) *http://www.finra.org/sites/default/files/finra_perspectives_on_customer_recovery.pdf* .

8 The RAND Study found similarly: "In interviews with interested parties, many claimed that the disclosures are problematic. First, they are not written in a way that is easily understandable to the average investor, and the information they provide is inadequate. Second, the financial service provider does not do enough to help investors understand the disclosures – that is, they present the required disclosures without taking time to explain them. Third, many said that investors do not take the necessary time and effort to fully read and understand disclosures." RAND Executive Summary, at xviii.

concluded that "[d]isclosure alone has proven ineffective to mitigate conflicts in advice."[9] They are also consistent with the conclusions of industry participants. TIAA recognized investor confusion "between the suitability standard to which broker-dealers are presently subject and the securities-law fiduciary standard to which RIAs are subject" that was "not sufficiently addressed by the current disclosure regime."[10] Morningstar put it even more starkly, concluding that "investors' confusion about standards of conduct . . . is likely to continue for some time, and disclosures alone will not clarify these standards for many investors."[11]

Second, once a relationship with a broker is established, investors do not easily incorporate new information such as representations made in a disclosure. "[O]nce a layperson-advisor relationship is created, it is likely to be sticky…. Once the layperson has a relationship with a conflicted advisor, a mere disclosure may not be enough to break that connection.'" Prentice, *Moral Equilibrium,* at 1083 (quoting Christopher Tarver Robertson, *Biased Advice*, 60 Emory L.J., 653, 674-75 (2011)).

Third, disclosures often use jargon and complicated math that the average investor may not fully understand. *See* Ben-Shahar & Schneider, *supra*, at 712 ("Financial privacy notices are written, on average, at a third- or fourth-year college reading level."). As a result, a regulation that relies heavily on disclosures, such as the Proposed Rule, does not adequately protect retail investors, and particularly the most vulnerable investors.

Fourth, the structure of the Proposed Rule also implicitly assumes that a retail investor, informed by the disclosures, can "distinguish good advice or investments from bad," or choose to invest with a different broker-dealer.[12] The reality is that the "same gap in expertise that makes investment advice necessary and important frequently also prevents investors from recognizing bad advice" and it is "unclear" how even a "sophisticated" and "attentive" investor "could determine whether or how a conflict has influenced" a recommendation.[13]

The notion that investors can find a superior broker-dealer is equally suspect.[14] It depends on an investor having the sophistication and time to comparison shop. It also depends on meaningful differentiation between broker-dealers – a prospect that is unrealistic if in fact all or most broker-dealers have substantively similar disclosure. For example, "[t]he disclosure that this particular broker does not

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9 Department of Labor, *Regulating Advice Markets* at 9 (Apr. 2016), *available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-_ rulemaking/1210-AB32-2/ria.pdf* (last visited July 29, 2018) (the "DOL Paper").

10 TIAA, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker Dealers* at 3 (Sep. 26, 2017), *available at https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2597428-161097.pdf* (last visited July 31, 2018).

11 Morningstar, *Standards of Conduct for Investment Advisers and Broker-Dealers* at 1 (Sep. 7, 2017), *available at https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2433284-161040.pdf* (last visited July 31, 2018).

12 DOL Paper at 9.

13 *Id.* at 9, 136.

14 *Id.* at 268 ("This argument necessarily presumes that investors will adequately understand the implications of disclosed conflicts and factor that understanding into their choice of adviser and investments. This presumption is highly questionable.").

owe them a fiduciary duty does not assist them in choosing among potential brokers if none of them owes a fiduciary obligation." Prentice, *supra*, at 1071. Similarly, under the existing regulatory scheme, customer agreements contain disclosures about mandatory arbitration of customer disputes. However, as most customer agreements contain the same substantive arbitration disclosures, the retail investor does not have any real bargaining power: he or she can sign the contract containing an arbitration provision or simply not invest. So too with respect to the disclosure requirements. The retail investor who wishes to open a brokerage account may in fact be required do so on a take-it-or-leave-it basis without any viable alternatives.

At bottom, while disclosure is an important component of any effective regulatory scheme, certain conflicts cannot be addressed by disclosure alone.

### D. The Proposed Rule, as Drafted, Contains Key Ambiguities That May Make Enforcement Difficult

The Proposed Rule does not clearly define certain key terms but rather, subjects the interpretation of the terms to a "facts and circumstances" test. These key undefined terms include the fundamental elements of the proposed regulation including:

- Conduct that constitutes acting in a customer's "best interests."
- A test for when a "recommendation" is made and the provisions of Regulation BI are triggered.
- Conflict of interest standards and the types of conflicted transactions that could be considered for mitigation or elimination.
- Standards for permissible disclosures as to fees and charges, type and scope of services, and material conflict of interest.

The failure to define these key terms poses several problems for both investors and the securities industry itself.

First, firms will be responsible for constructing a best interest program without any real assurance that it will be compliant. Firms may not have the ability to test their compliance until a regulatory examination, at which point their compliance programs will be subject to the judgment of the examiner. This could potentially impose additional regulatory costs and reputational risks if firms must pay fines and re-establish their programs after a negative finding in a regulatory examination.

Second, the ambiguities existing in the Proposed Rule also do not provide a clear means through which customers can evaluate the conduct of their financial professionals. Form CRS does not address the specific best interest obligations and transaction-specific disclosures necessary under the Proposed Rule. Customers would therefore be dependent on broker-dealers to create a compliant regulatory structure in the face of ambiguous definitions and the variable "facts and circumstances" for each broker-dealer. Without clear definitions and parameters, retail investors would independently have no means of making that assessment.

Third, there is no mechanism for developing a definitive and consistent body of law to resolve any ambiguities in the Proposed Rule's key terms. The Proposed Rule does not include a privately enforceable obligation that can be enforced in court, leaving its terms to be tested in: (1) regulatory examination; (2) enforcement actions; and (3) customer arbitrations where there is no requirement for a written decision absent agreement of the parties (FINRA Rules 12904(g) and 13904(g)). As such, no clear body of law relating to the Proposed Rule will be developed such that retail customers can assess whether their financial professionals are acting in accordance with the standards of conduct set forth in the Proposed Rule.

## III. Recommendations

In light of the above, and to ensure investor protection, the SEC must amend the Proposed Rule in several respects.

### A. The SEC Should Adopt a Uniform Fiduciary Standard

We recommend that the Proposed Rule be modified to adopt a uniform fiduciary standard for both broker-dealers and investment advisers, consistent with the recommendations of the 913 Study. In keeping with that study, the uniform fiduciary standard should include provisions that impose duties on the financial professional whenever that person is providing "personalized investment advice about securities to retail investors" (913 Study at 109), regardless of whether it is a broker-dealer or investment adviser account. The fiduciary standard should require the financial professional to:

- "act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or other investment adviser providing the advice." 913 Study at 110.

- "make a reasonable inquiry into a client's financial situation, level of financial sophistication, investment experience and investment objectives" before providing any personalized investment advice or entering into a transaction on behalf of the client. *See* Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. IA-4889, at 9-10; Regulation BI Release No. 34-83062 at 133-39; FINRA Rule 2111.

- use reasonable diligence in understanding and assessing investment products, including products outside their own firms which may be suitable for the customers of the financial professional. *See* Regulation BI Release No. 34-83062, at 133-39; FINRA Rule 2111.

- possess a "reasonable belief that the personalized advice is . . . in the best interest of the [retail investor] based on the [retail investor]'s investment profile." Investment Advisers Release No. IA-4889 at 11; Regulation BI Release No. 34-83062 at 133-39.

- "provide advice and monitoring over the course of the relationship with a [retail investor]," factoring into the advice any significant changes in the retail investor's financial profile. Investment Advisers Release No. IA-4889, at 14-15.

Imposing a fiduciary standard on all financial professionals as contemplated in the 913 Study: (1) elevates the professionalism of broker-dealers; and (2) ensures consistent and enhanced investor protection through an already developed body of law applicable to investment advisers.

### B. The SEC Should Adopt Stronger Protections against Conflicts of Interest and Require the Elimination of Certain Conflicts

We recommend that the SEC adopt enhanced conflict protections.

First, broker-dealers should be required to eliminate the most pernicious conflicts of interest and develop, maintain, and enforce written supervisory procedures consistent with this rule. This includes the following conflicts:

- "[C]ompensation thresholds that disproportionately increase through incremental increases in sales." Regulation BI at 182;
- "[C]ompensation incentives for employees to favor one type of product over another, proprietary or preferred provider products, or comparable products sold on a principal basis." *Id.*;
- "[C]ompensation incentives within comparable product lines" *Id.*; and
- "[S]ales contests, trips, prizes and other similar bonuses that are based on sales of certain securities or accumulation of assets under management." *Id.* at 18.

We recommend that differential compensation be permitted between categories of products or providers based solely on neutral factors. This includes the time and complexity associated with recommending investments within different product categories.

Second, consistent with the SEC's own conclusion in the 913 Study, a broker-dealer "should be required, at a minimum, to disclose its conflicts of interest related to principal transactions, including its capacity as principal…." 913 Study at 120. Whether that obligation should be met through pre-settlement disclosures akin to Section 206(3) of the Investment Advisers Act or an alternate disclosure mechanism should be determined by the SEC after additional analysis.

Third, broker-dealers should be required to identify, disclose, and mitigate or, alternatively, eliminate all other conflicts of interest, and develop, maintain, and enforce written supervisory procedures consistent with this rule.

### C. The SEC Should Improve Select Disclosure Mandates

While disclosures are no substitute for an enhanced duty of care and stronger conflict protections, they form an important part of the regulatory framework. We recommend that the SEC mandate meaningful and targeted disclosures that better protect the investing public.

First, this should include, as discussed above, full and fair disclosure of all material conflicts of interest.

Second, the SEC "should consider whether rulemaking would be appropriate . . . to impose specific disclosure and consent requirements" to address conflicts. 913 Study at 117. The SEC should, in particular, study "the type of information (and when it is provided) that would be most useful to investors to help them understand what a principal trade means and the potential risks and benefits." *Id.* at 120.

Third, consistent with the disclosure requirements of Form CRS, any disclosures should be "concise and direct and use short sentences, active voice, and definite, concrete, everyday words," with graphics and hyperlinks to additional disclosures as needed. Strict enforcement of Form CRS – beyond the creation of written supervisory procedures to address it – should be mandated. Such enforcement obligations should be required of the broker-dealers as well as the SROs that are conducting regulatory examinations.

Fourth, the disclosure mandates should include language in investors' contractual agreements that affirms the Proposed Rule's investor protections. This would enable investors to have a direct contractual cause of action and promote compliance with the rule. The Department of Labor took a similar approach in its Fiduciary Rule.[15]

### D. The SEC Should Ensure that Any Regulation Is Clear

In the interest of clarity to both investors and the securities industry, all key terms and provisions of a uniform fiduciary standard and its requirements should be clearly defined. Clear and uniform definitions will allow investors to understand the obligations owed to them by their financial professional. Likewise, the securities industry will be better able to establish an internal compliance structure that will conform to the requirements of the Proposed Rule. Finally, removing any ambiguity concerning the key terms will ensure that regulatory examinations will be uniform and fair across the industry.

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The Proposed Rule is an insufficient step for investor protection. The SEC must adopt a final rule that genuinely enhances investor protection by adopting our common sense recommendations, which draw from and build upon the SEC's own conclusions in the 913 Study and Congress' directives in the Dodd-Frank Act.

We look forward to continued dialogue as we work together to ensure a fair, transparent, and efficient market place.

We thank you for the opportunity to provide comment.

Respectfully,

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15 DOL Paper at 52.

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