August 07, 2018

Submitted via email: rule-comments@sec.gov

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

RE: RIN: 3235-AM35
File Number S7-07-18
Request for Comments Regarding Regulation Best Interest

Ladies and Gentlemen:

The diverse group of signatories, listed below, join together to respond to the Securities and Exchange Commission ("Commission") Request for Comments[1] regarding a proposed rule under the Securities Exchange Act of 1934 ("Exchange Act") establishing a new "best interest" standard of conduct for broker-dealers when making a recommendation of any transaction or investment strategy involving securities to a retail customer. The standard of conduct proposed is to "act in the best interest of the retail customer at the time a recommendation is made without placing the financial or other interest of the broker-dealer or natural person who is an associated person making the recommendation ahead of the interest of the retail customer." We also offer comments on the proposed disclosure for investment advisers and broker dealers to provide to their retail customers.

We are in complete agreement with the premise of this proposed rulemaking—that the standard of conduct required of broker-dealers when they make recommendations about securities to retail customers must be heightened because of the financial harm these customers incur from broker-dealers' conflicts of interest. We disagree, however, with the Commission's conclusion that material conflicts of interest associated with the broker-dealer relationship need to be mitigated or eliminated in only some cases or that mere "enhancements" to broker-dealers' current-law obligations will suffice.

The rule's most significant failing is that it does not establish a clear uniform best interest standard, one that is no less stringent than that found in the Investment Advisers' Act, for all professionals who provide investment advice to retail clients. Instead, it adopts a weaker standard for broker-dealers that falls short of a true best interest standard and does not adequately address the conflicts of interest that too often are permitted to taint broker-dealers' recommendations. Worse, its interpretation of the Advisers Act fiduciary duty further puts individual investors at risk because it reflects these same weaknesses. Regulation BI applies the best interest standard for broker-dealers to a narrower set of recommendations than for registered

[1] The notice was published in the Federal Register on April 18, 2018 (83 Fed.Reg.21574) and is available at https://www.gpo.gov/fdsys/pkg/FR-2018-05-09/pdf/2018-08582.pdf.

investment advisers. For example, it appears that a broker-dealer's recommendation that an individual take a lump sum distribution from a defined benefit pension plan would not be subject to the new best interest standard. As such, it perpetuates the confusion now faced by retail investors because the professionals they turn to for investment help are governed by different laws and, accordingly, held to different standards of conduct.

Indeed, most individuals mistakenly assume that professional investment advice across the board is provided with their best interest in mind. Unbeknownst to them, registered investment advisers are governed by a fiduciary best interest standard of conduct, while broker dealers are governed by a less stringent "suitability" standard, even when providing the identical advice services as registered investment advisers. Although Reg BI purports to raise that suitability standard to a "best interest" standard, the Commission fails to make clear what its proposed standard would require or what it would prohibit that is different from FINRA's suitability rules. There is no doubt, as it has been well documented, that this distinction is of great financial consequence to retail customers. As the Commission confirms in this proposal, just like the relationship between a registered investment advisor and her client, the relationship between a broker-dealer and her client "has inherent conflicts of interest which may provide an incentive to a broker-dealer to seek to maximize its compensation at the expense of the investor."

Second, experience tells us that the Commission's strong reliance on enhanced disclosure to enable investors to understand the nature of their investment professional's legal obligation to them will, in the end, provide investors with little, if any, meaningful protections from conflicts of interest. There is no evidence that investors read disclosure documents and there is no reason to believe that investors will view this particular disclosure as different, i.e. as anything more than the usual boilerplate and of financial consequence to them. Moreover, disclosure testing conducted on the Commission's behalf suggests that even if this new disclosure is read, it is not clear that investors will understand the difference between an advisory account and a brokerage account, particularly when brokers describe themselves as "financial consultants" or "wealth managers," as the proposal would allow. Indeed, at dual registrant firms where the nature of the relationship is likely to be most confusing to investors, brokers would remain free to call themselves "advisors" even when serving the client in a sales capacity.

Where the rule builds on the existing "suitability" duty of care now required of broker-dealers, purporting to implement a "best interest" standard, that standard is vague and undefined. This will lead to subjective and necessarily different interpretations. To the extent the proposal attempts to flesh out the new standard, it is internally inconsistent. For example, it requires that broker-dealers "put aside their financial incentives," on the one hand; and that such incentives not be the "predominant motivating factor" behind the recommendation, on the other. These are very different directives, leading to different outcomes in terms of the degree to which conflicts would be permitted to continue to influence recommendations. Further, although the proposal requires brokers to act in customers' best interest, it fails to make express that this requires the broker to recommend the investment that is the best match for the individual investor, an oversight that would appear to eviscerate the purpose of the rule.

While we support the proposal's requirement that brokerage firms implement conflict mitigation measures, this requirement lacks the necessary specificity to make it meaningful, i.e., to ensure that conflicts do not taint a broker's recommendations. For example, the Commission's suggestion that firms consider a non-exhaustive list of potential practices allows for an interpretation that a firm's mitigation obligation would be met after such consideration—absent any evidence that the chosen mitigation approach would be sufficient to prevent the conflict from inappropriately influencing recommendations. Further, while the proposal suggests that certain types of financial incentives might best be avoided entirely, such as sales quotas, sales contests, trips, and prizes, it does not actually require that they be eliminated. Instead, it leaves open the possibility that these incentives could be appropriate in certain circumstances, and thus virtually ensures that such practices will persist. All of these practices are directly at odds with any "best interest" standard because of the financial conflicts they create.

However, despite our significant concerns, we do not view the proposal as beyond repair. The Commission can build on its proposed rule to promulgate a final rule with a clear, uniform best interest standard, no less stringent than the Advisers Act fiduciary standard, for all professionals who provide investment advice to retail customers. To do so, it would need to:

- Clarify that brokers and investment advisers alike must act in the best interests of the customer, meaning that they must make the recommendations they reasonably believe represent the best available option for the investor.
- Clarify that broker-dealers, and their associated persons, are prohibited from allowing their conflicts of interest to influence their recommendations, and firms must have, and enforce, written policies and procedures to achieve compliance with the best interest standard.
- Require brokers to mitigate all material conflicts of interest, and clarify that the Commission will measure compliance with this requirement based on whether the action taken is sufficient to prevent the conflict from undermining compliance with the best interest standard.
- Prohibit brokers from adopting practices, such as sales quotas and contests, that clearly incentivize their representatives to base their recommendations on their own financial interests rather than the customer's best interests.

We are gratified that the Commission has begun this important rulemaking. It is enormously important to Americans who seek professional investment advice that will help them achieve their financial aspirations for themselves and their families, whether it is to be able to purchase a house, fund a child's college education, or retire in dignity. For the reasons we identified, the proposed rule offers them little more than an illusion of protection from their advice providers' conflicts of interest. Because they need and deserve better, we urge you to move forward along the lines we have suggested.

Thank you for your consideration of our views.

Sincerely,

Alliance for Retired Americans

American Federation of Labor and Congress of Industrial Organizations

American Federation of State, County and Municipal Employees

Americans for Financial Reform

Better Markets

Center for Economic Justice

Committee for the Fiduciary Standard

Consumer Action

EPI Policy Center

Florida Consumer Action Network

International Association of Machinists and Aerospace Workers

International Brotherhood of Electrical Workers

International Federation of Professional and Technical Engineers

Main Street Alliance

Montana Organizing Project

NAACP

National Association of Social Workers

National Committee to Preserve Social Security and Medicare

National Consumers League

National Employment Law Project

National Organization for Women

Pension Rights Center

Public Justice Center

South Carolina Appleseed Legal Justice Center

UnidosUS

U.S. PIRG

Woodstock Institute