CFA Institute

915 East High Street
Charlottesville, VA
22902-4868 USA

+1 (434) 951 5499 tel
+1 (434) 951 5262 fax
info@cfainstitute.org
www.cfainstitute.org

7 August 2018

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

Re: Regulation Best Interest (RIN 3235-AM35; File No. S7-07-18)

Dear Mr. Fields:

CFA Institute[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or the "Commission") on its proposed Regulation Best Interest ("Reg BI" or the "Proposal"). CFA Institute speaks on behalf of its members and advocates for investor protection and market integrity before standard setters, regulatory authorities, and legislative bodies worldwide. We focus on issues affecting the profession of financial analysis and investment management, education and competencies for investment professionals, and on issues of fairness, transparency and accountability of global financial markets.

Executive Summary

As proposed, Reg BI will increase, rather than lessen, investor confusion as to the applicable standard of care under which broker-dealers and investment advisers operate, in large part because brokers are to describe their best interest requirements in various disclosures. To avoid this potential problem, we encourage the Commission make a clearer distinction between the standards, both in terms of disclosure and the substantive duties that are required under each.

As part of this effort, we believe brokers should provide "full and fair disclosure" of material conflicts of interest. Otherwise, the proposed standard would not correspond with investors' perceptions of what best interest means and, instead, shortchanges investor protections.

We also encourage revisions to the Proposal to prohibit certain conflicts of interest and require better disclosure of other conflicts. Material conflicts of interest stemming from certain financial incentives to broker-dealers have no place in a standard that claims to be in clients' best interest.

[1] CFA Institute is a global, not-for-profit professional association of more than 160,000 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 153,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 150 member societies in 73 countries and territories.

Background

As an organization of investment professionals committed to investor protection, CFA Institute has long urged the SEC to take the lead in proposing a standard of conduct for all who provide personalized investment advice to retail investors. We commend the SEC for taking these important steps toward fulfilling its mandate for investor protection, and for addressing the investor confusion that currently exists among consumers as to the standards of care used by their advice providers.

We also recognize the difficulty and challenges of trying to reconcile the business models of different advice providers, all with an eye toward maintaining the broadest possible range of investment and advice options for investors. At the same time, we recognize that conflicted advice and the investor confusion created by different standards of conduct used by advice providers has very real costs for investors.

Over the years, we have encouraged the SEC to remedy these problems by adopting a uniform fiduciary duty standard for all who provide personalized investment advice to retail investors. This is not only consistent with the high standard imposed on investment advisers whose ongoing investment advice is regulated by application of the Investment Advisers Act (the "Advisers Act"); it also is consistent with the view of SEC staff[2] (the "913 Study").

We do worry that as proposed, the best interest standard (the "Proposed Standard") does little to clarify the boundaries of the solely incidental advice exemption for broker-dealers from non-incidental personalized investment advice. Therefore, as discussed below, we believe this will contribute to added confusion on the part of retail investors and possibly short change those investors from receiving investment advice that truly puts their interests first unless the SEC clarifies things once and for all. Our suggestions below touch on a more objective, bright-line for what would constitute incidental advice going forward which is instructive and straight forward for both the broker/practitioner and customer.

In the following pages, we suggest changes that we believe will improve the Proposal. We hope these comments will help produce a rule that better protects investors from mis-selling and will raise the level of market integrity and professionalism in the broker-dealer community.

Discussion

Before providing comments on specific aspects of the Proposal, we first want to provide general comments on the issue of personalized investment advice, and touch on the interrelatedness of the three-part package of consultations issued concurrently by the SEC. Aspects of this package need to be considered together, as they affect the premises on which Reg. BI rests, and in some ways are dependent upon each other.

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[2] See the Study on Investment Advisers and Broker-Dealers (January 2011), at https://www.sec.gov/news/studies/2011/913studyfinal.pdf.

General Comments

Need for Clarity and Consistency

We believe that clarity, consistency and coordination of standards is central to the success of any new regulation in this area. The standards of conduct that apply to broker-dealers and investment advisers has confused investors for many years, as have the actual services they can expect to receive from each.[3] In fact, some investors do not know whether the suitability or fiduciary duty standard is higher.[4] Given these hurdles, retail investors need clear and direct statements that educate them about conduct standards and help them distinguish between these standards and the services to which they attach. Otherwise, the significance of any new standard for broker-dealers will be lost on the average retail investor.

A final rule needs to define in clear and consistent terms what comprises a best interest standard. And this definition needs to clearly and succinctly distinguish a best interest standard from the fiduciary standard to benefit investors. Only with this understanding will investors be able to make meaningful choices about the standard of care most applicable to their circumstances, objectives, and time horizons as they consider the range of services and accompanying costs offered by broker-dealers and investment advisers.

The Proposed Standard must also achieve two goals: it must be grounded in legal obligations that include acting in the investor's best interest; and investors must be able to understand, and distinguish this standard, from the standards applicable to investment advisers. We believe these pose significant challenges to the Proposal.

Application of standards for anyone who provides investment advice also need to be consistent in order to minimize investor confusion. We think the Proposed Standard needs revising to achieve this baseline objective.

Need to Define "Personalized" Advice

Moreover, creating a broker-dealer standard for the provision of personalized advice requires guidance of what constitutes "personalized." Without such clarification, investors and broker-dealers, alike, will remain confused about the boundaries of certain actions and the extension of applicable standards. In deciding to use the term, "recommendation," for purposes of the Proposal, the SEC reasons that in the broker-dealer context, "recommendation" is the equivalent of personalized investment advice. If this is so, then it appears the SEC has previously permitted the equivalent of personalized investment advice to be provided under a suitability standard.

Most importantly, investors will lack the clarity for knowing if the advice they receive is for their financial wellbeing, or is driven, instead, by the financial wellbeing of the broker and the financial firm that is selling them financial products. We therefore encourage the SEC to issue administrative guidance on the definition of "investment adviser" in section 202(a)(11) of the

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[3] Id., citing both the 2006 RAND Report and 2010 survey conducted by the Consumer Federation of America, pps.96-101.
[4] Id. (noting RAND Study)

Advisers Act to clarify that providing personalized investment advice brings one within the definition.

Need to Define "Incidental" Advice

A close corollary to defining "personalized advice" is the need to give guidance on what advice is "incidental" to the broker-dealer's business to qualify under the "incidental exemption" afforded by section 202(a)(11)(C) of the Advisers Act. As noted in our 10 January 2018 letter, we believe the SEC has legal authority to provide this clarification.[5]

Such guidance is needed because through this Proposal, the SEC appears to equate broker-dealer "recommendations" with advice that is merely incidental. But if recommendations exceed what is incidental, broker-dealers providing them qualify as advisers and thus must be held to a fiduciary duty, not a best interest, standard.

We agree with the statement in the Proposal that "it is appropriate for the Commission to again consider the scope of the broker-dealer exclusion with regard to a broker-dealer's exercise of investment discretion in light of both Regulation Best Interest and the proposed Relationship Summary." The SEC asks a number of questions about whether it should further address "solely incidental" especially in terms of the exercise of investment discretion. We agree that such an approach could provide needed clarity in this area. We would support an interpretative rule from the SEC that, among other things, defines incidental advice as that provided by brokers when clients retain investment discretion. We believe that when the broker-dealer retains any investment discretion over its client's account, its recommendations are no longer solely incidental to its business, as contemplated under section 202(a)(11)(C) of the Advisers Act, and would require registration as an investment adviser. We welcome updated guidance on whether the SEC still envisions situations where broker-dealers would be seen as having limited or temporary investment discretion but still be able to claim the incidental advice exclusion.

Enforcement and Mitigation Factors

We recognize the importance of enforcement for whatever form of the Proposal the Commission adopts, and we are advised by the Commission of the importance policies and procedures will have in enforcing any final rules. While we appreciate the principles-based nature of the Proposal and the flexibility afforded broker-dealers, the final standard must have enforcement "teeth" in order to be effective. Requiring policies and procedures thus provides regulators with basic tools with which to weigh enforcement decisions.

Given the lack of definition of the proposed best interest standard, we believe that having enforceable policies and procedures aimed at mitigating certain conflicts of interest is particularly important. To that end, we provide in Appendix A descriptions conflicts of interest that are common to the broker-dealer business model with suggested mitigation techniques. We strongly believe broker-dealers and investors will benefit from clear guidance on how to mitigate

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[5] Letter to Brent J. Fields, Secretary, Securities and Exchange Commission from Kurt N. Schacht, James C. Allen and Linda L. Rittenhouse (10 January 2018).

conflicts and urge Commission consideration of incorporating these recommendations into required policies and procedures.

Form CRS and the Lack of Investor Testing

As noted throughout this Proposal, the disclosure requirements of Reg. BI and whether they reduce investor confusion are to be considered in conjunction with the requirements of its companion proposal—the customer relationship summary ("CRS"). This is relevant given that the SEC is striving for an effective "layered" approach to disclosure. In fact, Reg. BI requirements are built on the premise that CRS will be sufficient to provide certain basic information to investors. Used together, they are supposed to eliminate the confusion investors have about different service providers and provide investors with the information they need to make informed decisions.

However, we cannot fully evaluate the Proposal without knowing investors' responses to the CRS disclosures and whether, as proposed, they provide the basic clarity needed to properly supplement Reg. BI. While the Commission indicates it is and will be conducting investor testing, we are asked to comment without the benefit of this testing. Whatever comments we provide herein will therefore be based only on limited information and conjecture, rather than on actual data that could inform a more informed response.

While we provide specific comments below, we do so with the caveat that they lack the information that is needed to fully address the issue.

Rejection of Fiduciary Duty Standard

In discussing the various approaches that were considered in formulating Reg. BI, the Proposal notes that it relied upon many underlying principles and recommendations contained in the 913 Study. The conspicuous difference between that study and this Proposal is rejection of the recommendation to adopt a uniform fiduciary duty for broker-dealers and investment advisers when providing personalized investment advice about securities to retail investors.

Most comments filed in response to the SEC's request for information on how to address the differing standards for investment advisers and broker-dealers supported a uniform fiduciary standard of conduct. As the Proposal notes, the SEC's own Investment Advisory Committee submitted a 2013 recommendation supporting a uniform fiduciary standard. And it appears that many who responded to Chairman Clayton's most recent request for information also supported a single uniform standard. Despite this groundswell of support from SEC staff, industry and the public, the SEC, through this rulemaking, has chosen to disregard the input it solicited in favor of a different approach.

In explaining its approach, the SEC says it believes "it makes more sense to build upon this regulatory regime, rather than to create a completely new standard or simply adopt obligations and duties that have developed under a separate regulatory regime to address a different type of advice relationship." We would argue that Reg. BI *is* a new standard.

The SEC reasons that the nature of the broker-dealer business model (and that it does not provide for ongoing relationships with its customers) does not warrant a fiduciary standard. Even if the SEC believes that broker-dealer advice is episodic, we would argue that should not preclude a fiduciary standard attaching at the time recommendations are made.

Moreover, in supporting its approach for the Proposed Standard (rather than a fiduciary one), the Proposal cites statements from commenters that investors already believe broker-dealers are acting in their best interests. We find this argument tautological, as brokers who are providing non-incidental advice must, by virtue of the Advisers Act, adhere to a fiduciary standard of care and therefore refrain from putting their own interests ahead of their clients' interests. Imposing a fiduciary standard on broker-dealer recommendations, therefore, would still be in keeping with these investor expectations.

And perhaps of more concern is that if enacted, there will be two standards for providing personalized investment advice — one through securities recommendations and the second through a more-traditional advice model. While the package of proposals purports to provide investor clarity as to standards of conduct, we contend the result will be the contrary.

Investor Expectations

An oft-repeated explanation for the Proposed Standard is that it is in keeping with investor expectations. Discussion throughout the package of proposals notes that investor expectations are a primary driving force for formulating the Proposed Standard and its requirements. Yet, as many retail investors continue to express confusion as to the different services provided by broker-dealers and investment advisers, we believe aspects of the Proposed Standard may come as a surprise to them.

For example, the Proposed Standard of conduct under Reg. BI would apply only "at the time the recommendation is made." We are concerned that clients will not understand that whatever standard of conduct applies for broker-dealers, that that standard will apply only at and for the time of a recommendation. We also are concerned that they will not comprehend what this limitation may mean for the advice they receive.

An investor who uses a broker-dealer solely for trade execution knows what to expect from that relationship. By comparison, it is entirely appropriate that a client with an ongoing and longstanding relationship with a specific broker, a relationship that involves ongoing recommendations, may expect an ongoing standard of care that extends beyond the precise timing of any particular recommendation.

In keeping with our request for more testing of investor understanding of the disclosures proposed within the CRS, we would welcome a fuller understanding of whether investors expect advice from their broker-dealers to have such a short shelf life. We understand the SEC is conducting outreach meetings with investors across the country, and we hope the input they receive helps to improve the final form of both Reg. BI and the CRS.

Without a clear delineation of how the Proposed Standard differs from a fiduciary duty standard, we believe investors will remain confused as to what they can expect. This is due to our concern that customers will believe their interests come first after reading disclosures stating that broker-dealers operate under a best-interest standard.

To prevent confusion about what a "best interest standard" is, we recommend replacing the proposed statement, "without placing the financial or other interest ahead of the retail customer," with, "without regard to its financial or other interest."[6] Another alternative might be to say, "by placing the interests of the retail customer ahead of the broker-dealer." While only a slight difference in wording, we believe this rephrasing would meaningfully shift the duty of care toward the customer, and therefore would more-closely reflect a true "best interest" approach.

Second, many aspects of the Proposal note the suitability standard as a basis on which the Proposed Standard is based. At the same time, though, it contends that the Proposed Standard makes "enhancements" to "existing suitability obligations under the federal securities laws" and to obligations that already exist under FINRA's suitability rule. We do not disagree.

But we also believe the Proposed Standard leans more toward a suitability standard than toward a fiduciary duty, and therefore not fully reflective of what a true "best interest standard" might mean to investors. To move toward such a true best interest standard, we believe certain conflicts must be avoided, as discussed further in this letter.

Specific Comments

Regulation Best Interest

Regulation Best Interest requires that when making a recommendation of any securities transaction or investment strategy involving securities, broker-dealers must act in the best interest of retail customers at the time the recommendations are made and without placing their own financial or other interests ahead of their customers'. Because Reg BI is principles-based and purposefully undefined in the Proposal, Reg BI has two inherent problems. First, by not defining, and thus not holding broker-dealers to a particular standard, neither investors nor broker-dealers actually know what to expect. And second, by not defining the Proposed Standard, broker-dealers may find themselves liable for conduct they didn't expect would cross a regulatory line.

While we appreciate the SEC's attempt to provide broker-dealers with flexibility through the use of a principles-based approach, we believe the Proposed Standard needs more definition. Given the discretion afforded broker-dealers to decide if they must disclose, as well as when and how to disclose, the Proposed Standard lacks the clarity and certainty of application that otherwise provides investors with reliable safeguards.

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[6] See section 211 (g) (1) of Advisers Act.

To meet the requirements of Reg. BI, broker-dealers must comply with three primary components: (1) Disclosure Obligation; (2) Care Obligation; and (3) Conflict of Interest Obligation.

A. *Disclosure Obligation*

Reasonably disclose. Under the Disclosure Obligation, broker-dealers must, prior to, or at the time of any recommendations, "reasonably disclose" the material facts relating to the scope and terms of the relationship, and all material conflicts of interests associated with the recommendations. The adequacy of the "reasonably disclose" requirement is a facts-and-circumstances determination. As part of the Commission's proposed "layered disclosure" approach, the information required by Reg. BI's Disclosure Obligation would complement information presented through the CRS, although with more specificity about fees and conflicts of interest, along with the type and scope of services. The "reasonably disclose" requirement allows broker-dealers a great deal of discretion in deciding how to provide this disclosure to their customers.

We urge the SEC to reconsider this approach. While examples of what would likely be disclosed are provided, there is no explanation of what it means to "reasonably" disclose. If it is the same standard as, "to disclose," then the "reasonably" qualifier should be dropped. If this is a lesser standard, it should be explained.

We also believe that clear and prominent disclosure of certain conflicts should be mandatory, not discretionary, particularly when they involve financial incentives. For example, we believe the SEC should make mandatory the disclosure of conflicts relating to recommendations involving proprietary products, and all conflicts involved in rollover recommendations.

We further urge the Commission to require disclosure of the standard of conduct under which broker-dealers operates. While disclosed in the CRS, this disclosure is so important to investors that it warrants a regular reminder.

In response to a question posed in the Proposal, we also urge that broker-dealers provide updated disclosures at least 30 days before raising or imposing new fees. This is not a requirement under the Proposal as drafted, but such an update about a material change in the terms of services provided would be important to investors and should be mandatory.

Finally, we believe brokers need to disclose all conflicts of interest to their clients. While the Commission may wish to limit more complete descriptions to material conflicts of interest, we believe it is imperative that investment clients are aware of all the conflicts of interest that may affect the recommendations they receive.

Timing of disclosure. We believe the timing of disclosure under this requirement, as it is with Form CRS, is problematic. Providing disclosures on fees and material conflicts of interest *at the time* recommendations are made is too late. Investors need this information ahead of time in order to permit meaningful decisions as to whether to engage, or continue with, a particular services provider.

And while the Proposal requires disclosure "prior to" or at the time of recommendations are made, it does not say how much ahead of the recommendations the information must be disclosed. We support a requirement that broker-dealers be required to post information about fees, material conflicts of interest and capacity on their websites and, when aware of a potential customer's interest, provide links to their websites at the earliest possible time. To be fully useful, this information must reach investors before decisions are made about which providers to choose. Expecting investors who receive this information at the time of engagement to end the discussion and seek a different provider based on that information is, in most cases, unrealistic.

Full and fair disclosure. The Proposal notes that Reg. BI's conflict of interest interpretation is based on the Adviser Act's "well-established Commission precedent regarding conflicts of interest for which advisers may face antifraud liability under the Advisers Act in the absence of full and fair disclosure." Thus, the Proposal is clear in noting its reliance upon the Adviser's Act and associated rules.

We believe the final rule should require broker-dealers to provide "full and fair" disclosure of material conflicts of interest as this is most consistent with what constitutes a best interest standard. Anything less would not only be inconsistent with such a standard but would also shortchange investors as to what they can reasonably expect from those providing securities recommendations while claiming to be acting in their best interests.

Layered disclosure. Finally, the Proposal is clear that the information required under the Disclosure Obligation is to be layered with the information in the CRS. But it is not clear how this "other information" is to be provided. In response to a question in the Proposal, we believe that providing relevant disclosures through these two different sources and approaches is potentially confusing to investors. Should the SEC decide to proceed with a layered disclosure approach, we recommend it provide additional guidance as to how this "other" disclosure will dovetail with the information to be provided through the CRS, including acceptable methods.

B. Care Obligation

Under the Care Obligation, broker-dealers would be required to use reasonable diligence, care, skill and prudence to understand the risks and rewards associated with their recommendations. Further, they must have a reasonable basis to believe that their recommendations could be in the best interests of some retail customers; a reasonable basis to believe they are in the best interest of particular retail customers; and a reasonable basis to believe a series of recommendations would not be excessive and overall would be in specific customers' best interests when considered in light of those customers' investment profiles. The Proposal makes clear that disclosure alone cannot satisfy the Care Obligation.

We note language in the Proposal that emphasizes that the requirements of this obligation "incorporate and enhance" existing broker-dealer suitability requirements. This oft-repeated theme reinforces our view that Reg. BI is more of a "suitability-plus" standard, rather than a true "best interest" one, and should be considered as such.

Cost of product. We support the reasoning that a product does not have to be the least expensive to be in a client's best interest, based on particular client objectives and investment profiles. What is in the best interests of a client depends on the specific investment goals and standing of a client. This would mean that a more expensive, riskier, or less-liquid investment might be better suited to realizing some clients' objectives. While we support the flexibility given to broker-dealers to make this determination, we believe it must be made judiciously and supported with documentation, especially when the recommendations involve proprietary products.

The Proposal asks whether broker-dealers should have to recommend the least expensive option if "all other relevant factors are equal." If a less expensive option would meet a customer's investment objects, we do not see why an investor should pay more for an alternative. We invite a fuller explanation of "relevant factors" and examples of when added cost might be justified.

We also believe that broker-dealers offering proprietary products must provide specialized disclosure that highlights the potential higher costs to their customers. When a broker-dealer *only* offers proprietary products, it should clearly and unequivocally call attention to not only the higher product cost, but the potential cost to the investor of such a limited offering. We recommend that there be policies and procedures specifically addressing this area.

Sales contests. Discussion in the Proposal indicates that making recommendations aimed at winning sales contests or meeting firm quotas would be inconsistent with the Care Obligation, while other discussion within the same Proposal appears to allow them. Our view is that recommendations aimed at winning sales contests and meeting internal quotas are irreconcilable with the concept of a best interest standard and should not be allowed.

We suggest that the final rule expressly include best execution, fair pricing and compensation as factors that must be considered under a Care Obligation. Even though federal securities laws and SRO rules already require them, these factors are basic to any best interest standard and should be included.

Similarly, we recommend that broker-dealers have to "take into account all benefits to the broker-dealer or associated person from the recommendation and the costs to the retail investor." Again, we think this is a basic part of the analysis when determining best interest.

C. Conflict of Interest Obligation

Under this obligation, broker-dealers must establish, maintain and enforce policies and procedures that are "reasonably designed" to identify and disclose, or eliminate, material conflicts of interest associated with their recommendations. With respect to material conflicts of interests arising from financial incentives related to specific recommendations, the policies and procedures would identify and disclose and mitigate, or eliminate those conflicts of interest.

Simplified and direct responsibilities. We find this approach to conflicts of interest to be overly complicated and recommend simplification as a remedy. As a first-tier exercise, we ask the SEC to provide clarification and examples of when a material conflict of interest does *not* involve a

financial incentive. If material conflicts of interest are found to always involve financial incentives, then one overall standard should apply.

We also question the requirement that broker-dealers create, maintain and enforce "reasonably designed" policies and procedures as one that could be read as lessening their compliance obligations. Instead, we recommend consideration of a more direct responsibility on broker-dealers to identify and disclose or mitigate/eliminate, as the case may be. Whatever *method* they use (e.g., policies and procedures, or others) will be within their discretion, but will not lessen their primary *responsibilities.* Given the predominantly principles-based approach favored by the Proposal, this requirement should still provide broker-dealers with ample flexibility on how to meet their obligations.

As a rationale for the policies and procedures approach, the Proposal notes that this helps investors by lowering compliance costs that could be passed on by their broker-dealers. We believe the more relevant and important question is whether the potential costs that could be passed on to investors outweigh the costs to investors of a standard that is less stringent than a true best interest one. While we appreciate and support an approach that provides flexibility to broker-dealers, we also believe rules should err on the side of narrow interpretation in lieu of maintaining flexibility when they represent to clients they are acting under a best interest standard.

Financial Incentives. While the discussion of this Obligation notes that it would be better practice to eliminate some conflicts of interests relating to financial incentives (such as sales contests, trip prizes, etc.), especially when dealing with unsophisticated clients, the broker-dealer is not *required* to do so. In fact, the Proposal is clear that the Conflict of Interest Obligation "does not mandate the absolute elimination of any particular conflicts, absent another requirement to do so. The absolute elimination of some particular conflicts could mean a broker-dealer may not receive compensation for its services, which is not the Commission's intent." We find this reasoning concerning and not supportive of a true best interest standard.

Section 211(h)(2) of the Advisers Act expressly imbues the SEC with authority to "[e]xamine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for broker, dealers, and investment advisers that the Commission deems contrary to the public interest and protection of investors." We encourage the SEC to apply this provision in the prohibition of, or severe restriction on the ability of broker-dealers to claim they are acting in the best interest of their clients when making recommendations whose benefits rebound to the broker-dealers through sales contests, trip prizes firm quotas, prizes, or other bonuses based on the volume sales of securities.

We believe recommendations aimed at winning sales contests are obvious conflicts of interest that do not honor a best interest standard. Yet guidance in the Release seems conflicted on how those incentives should be treated. In one place, the Proposal notes that sales contests would violate Reg. BI if the recommendation is "predominately motivated" by a broker-dealer's self-interest (and would not otherwise be in a customer's best interest). Later the Release notes that

certain financial incentives may be more difficult to mitigate and perhaps should be avoided in their entirety when dealing with certain customers, noting sales contests as an example.

These varying warnings are helpful, but sales practices are not *per se* prohibited and participation is within the broker-dealer's discretion when deciding whether and how to mitigate or eliminate. While we generally support flexibility and principles-based approaches, we believe this is an example of a financial incentive that should be prohibited when honoring clients' best interests, as we cannot think of a situation when the two would be consistent.

If financial incentives are created to induce a broker-dealer to make recommendations at the expense of customers, a best interest standard would *require* the elimination of those conflicts. By vesting broker-dealers with discretion to decide what actions to take and not requiring them to eliminate certain conflicted interests, this standard appears to put the financial interests of broker-dealers before their customers. We therefore encourage the SEC to revise its approach and prohibit certain practices primarily aimed at realizing firm or individual profits, including sales contests, trips, firm quotas, prizes, other bonuses based on the volume sales of securities, and the sales of certain securities.

We also recommend that the final rule not just prohibit certain existing practices, but also encourage broker-dealers to *avoid creating* certain conflicts. With that responsibility in mind, this approach may engender a more holistic view toward innovations in the industry that consider the interests of clients *ex ante* and help obviate the need for managing conflicts later.

In addition, we note a particular question asked in the Proposal about whether retail investors recognize and understand the conflicts of interest posed by broker-dealer compensation arrangements, including "the incentive to seek to increase the broker-dealers' compensation at the expense of the retail customers they are advising." We believe that the average retail investor would not recognize the nuance of this conflict of interest, absent direct and explicit disclosure and where this is explicitly explained as a conflict of interest.

And to that end, we welcome consideration of a requirement—either as part of this Conflict of Interest Obligation or as part of the CRS—to provide a clear English listing of all conflicts of interest in which the particular broker-dealer engages. While maintaining the flexibility and discretion afforded broker-dealers to decide when to disclose and mitigate or eliminate conflicts of interest, it also empowers customers with highly relevant information. We think a clear understanding of specific conflicts is particularly important when broker-dealer recommendations involve retirement funds, including rollovers.

Alternatives Approaches

As an alternative to proposed Reg. BI, the SEC notes that it could impose a fiduciary standard on broker-dealers for retail customers. In keeping with our longstanding positions, and consistent with the discussion above, we would favor this direction as in keeping with a higher standard of conduct that we believe investors deserve.

In discussing this alternative, the SEC notes the advantages of having the same standard for advice, whether provided by investment advisers or broker-dealers: greater uniformity to standards of conduct for advice to retail customers; potential reduction of conflicts and increased disclosure that enhances the quality of advice; reducing potential harm to investors; and potential reduction of investor confusion. We agree with all of these potential advantages and urge the SEC to reconsider adopting this approach.

Conclusion

We support the SEC's efforts to bring greater clarity to the standard of conduct for broker-dealers when providing investment advice to their retail customers. We believe the best approach would be through requiring a fiduciary duty standard to attach to the providing of such advice, whether that advice is episodic or ongoing. Should the SEC decide to proceed with a best interest standard for broker-dealers, we recommend a number of substantive revisions, to better align broker-dealer obligations with investor interests.

Should you have any questions about our positions, please do not hesitate to contact James Allen, CFA james.allen@cfainstitute.org, 434-951-5558 or Linda Rittenhouse at linda.rittenhouse@cfainstitute.org, 434.951.5333.

Sincerely,

/s/ Kurt N. Schacht

Kurt N. Schacht, CFA
Managing Director,
CFA Institute Advocacy

/s/ James Allen

James Allen, CFA
Head, Capital Markets Policy
CFA Institute Advocacy

/s/ Linda L. Rittenhouse

Linda L. Rittenhouse
Director, Capital Markets
CFA Institute Advocacy

Appendix A

Sample Regulation Best Interest Policies and Procedures to Address Conflicts of Interest Common to Broker-Dealers

Within proposed Regulation Best Interest, the Commission notes that under its Conflict of Interest Obligations, a broker-dealer entity would have to "(1) 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 recommendations covered by Regulation Best Interest; and (2) 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 recommendations."

As part of its response to the Commission's Proposal, CFA Institute highlights the following broker conflicts of interest and recommended methods for mitigation.

- ***Conflict—Sales Inducements:*** Firms encourage higher sales of certain products and services by brokers through sales inducements for a) specific investment products whose sponsors offer firms and their brokers higher commissions; b) specific securities to reduce a firms' exposure to the securities' issuers; c) principal transactions with built-in but undisclosed transaction costs; or d) more-profitable proprietary products. Conversely, firms may reduce inducements on certain products or services to discourage their sale in favor of selling others whose inducements are not reduced.

  Recommended Mitigation: Firms should not offer inducements to encourage or discourage the sale of certain products or services that may not be in clients' best interests, including those:

  - offered by third-party investment firms to promote the sale of their products or services;
  - initiated by the firm to reward increased sales of select products or services;
  - initiated by the firm to reward increased sales of principal transactions;
  - initiated by the firm for meeting or exceeding sales quotas of certain products or services; or
  - initiated by the firm to discourage sales of certain types of products.

  Firm should apply differential inducements only to reflect the time and effort needed to execute complex customer orders. Firms also should reduce compensation for brokers who fail to adequately manage conflicts of interest.

  Brokers must assess annual fee structures for investment products and services considered for retail customers, the performance records of investment product managers, any rebates awarded to the firm for selling certain products, the quality of sponsoring firms, etc. Acting in the best interest of a customer typically requires products that are

lower cost, have solid performance, have quality sponsors and managers, and have low or no sales charges. Brokers should fully document customer discussions and decisions around these matters.

- ***Conflict—Redundant Investments:*** Brokers put customers in products with similar structures, similar strategies and/or similar exposures to boost sales for multiple fund sponsors at the expense of redundant diversification and unnecessary costs for clients.

  Recommended Mitigation: Firms must refrain from placing customers in multiple investment products or securities that have similar investment strategies, structures, and investment exposures. Doing so will help avoid raising the risk exposure of customers' holdings, increasing costs, reducing returns, and impairing long-term outcomes. Brokers must properly consider the best interests of clients' investment activities, expenses, and returns before recommending investment options.

- ***Conflict—Monitoring Turnover of Client Holdings:*** Brokers encourage frequent trading (churning) by clients in order to generate higher commissions for their firms and themselves.

  Recommended Mitigation: Firm must monitor trading activity in clients' accounts to ensure trading is used solely to enhance client returns. Trading may suit investor purposes when it enables them to take advantage of positive investment opportunities, or when it helps to reduce investment losses. However, higher trading costs reduce investors' returns and therefore are not necessarily in the best interests of clients. Brokers must be encouraged to properly consider the best interests of clients' investment activities, expenses, and returns before suggesting active trading programs.

- ***Conflict—Commissions vs. Fees:*** Brokers put clients into accounts with structures designed to generate higher fees/commissions for their firms rather than better outcomes for clients.

  Recommended Mitigation: Brokers and advisers should determine which compensation arrangement will produce the best outcome for each client. Commission-based fees, for example, are often more efficient and fair for long-term, buy-and-hold customers. Fee-based structures, on the other hand, are generally more useful for relationships that require significant account monitoring and involve frequent changes in holdings. For small-AUM customers, per-hour or per-project arrangements may serve clients' interests best.

- ***Conflict—Mis-Selling on Retirement Plan Rollovers:*** Brokers encourage retirement plan rollovers for clients to generate large fees for the rollover, and higher on-going account fees thereafter.

Recommended Mitigation: Brokers should determine whether the rollover of retirement plans or cashing-out of insurance policies serve clients' best interests in light of new rules before making recommendations on such matters.

- ***Conflict—Selling of Complex Products or Services:*** Brokers sell high-cost and highly complex investment products that are unsuitable for certain retail and institutional customers, including annuities, highly structured exchange-traded funds, or unit investment trusts that employ complex structures that impair the ability of investors to sell the products without significant cost.

  Recommended Mitigation: Brokers should provide customers with a comprehensive description of costs and risks to go along with any discussions of benefits that may arise from complex financial instruments or services. Firm staff must take reasonable steps to ensure they and their clients are aware of the costs, and aware of potential risks such as limited liquidity, high up-front and back-end costs, and the potential failure of an institution promising guaranteed future income for recommending such products. Brokers must consider whether the sale of complex financial products are suitable and serve their clients in the context of new best interest requirements.