July 16, 2018

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

VIA ELECTRONIC MAIL: rule-comments@sec.gov

Re: File No. S7-07-18: Regulation Best Interest; and File No. S7-08-18: Form CRS Relationship Summary

Dear Mr. Fields:

The Committee on Capital Markets Regulation (the "**Committee**") is grateful for the opportunity to comment on the Securities and Exchange Commission's (the "**SEC**") package of proposals to: enhance the standard of conduct for broker-dealers when making securities transaction or investment strategy recommendations to retail customers (File No. S7-07-18, "**Regulation Best Interest**")[1]; and require registered investment advisers and broker-dealers to provide a relationship summary to retail investors (File No. S7-08-18, "**Form CRS Relationship Summary**,"[2] collectively with Regulation Best Interest, the "**Proposals**").

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-five leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and directed by Hal S. Scott (Emeritus Nomura Professor of International Financial System at Harvard Law School). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

We commend the SEC for submitting these Proposals for public comment. We believe it is an appropriate time to adopt a best interest standard applicable to broker-dealers making recommendations to retail customers that applies uniformly to all account types. And we believe that the SEC is the appropriate agency to lead such an effort because of its expertise in securities markets. The Proposals should help reduce customer confusion about the duties owed to them by their broker-dealers. We also applaud the SEC's adoption

[1] Regulation Best Interest, 83 Fed. Reg. 21,574 (May 9, 2018).
[2] Form CRS Relationship Summary, 83 Fed. Reg. 21,416 (May 9, 2018). The SEC also put out a proposed interpretation regarding standard of conduct for investment advisers, which we are not addressing.

of a principles-based approach in Regulation Best Interest that provides firms with the necessary flexibility in complying with its requirements.

However, we have three concerns with the Proposals. First, Regulation Best Interest contains standards that the SEC states will be evaluated based on the totality of the circumstances and will thus be subject to significant interpretation. We agree with a principles-based approach but emphasize that the SEC will need to work closely with the industry to provide feedback and guidance as the regulation is implemented. Second, the Form CRS Relationship Summary is excessively complicated and should be shortened and simplified with supplemental disclosures made available online. Third, and very importantly, we believe that any Department of Labor ("**DOL**") rules regulating broker-dealers under the Employee Retirement Income Security Act of 1974 ("**ERISA**") and the Internal Revenue Code (the "**Code**") should be made consistent with the SEC's regulation of broker-dealers and the Proposals.

The SEC's Proposals

To date, the SEC has not adopted rules explicitly governing the conduct of broker-dealers when they are providing recommendations to retail customers. Historically, such conduct has been governed by rules of self-regulatory organizations,[3] application and interpretation of federal securities laws,[4] and state common law.[5]

In 2016, the DOL promulgated a rule under ERISA and the Code commonly referred to as the fiduciary rule.[6] This rule vastly expanded the situations in which broker-dealers would be deemed to be "fiduciaries" of ERISA plans or individual retirement accounts and thus prohibited from entering into certain transactions with clients.[7] For example, under the "prohibited transaction" provisions, a broker-dealer deemed to be a fiduciary cannot engage in principal transactions with the customer or charge transaction-based commissions.[8] A broker-dealer can avoid the prohibitions if it adheres to certain onerous requirements and subjects itself to potential private litigation.[9] Critically, the DOL rule applies only to retirement accounts. As a result, the customers with both retirement and non-retirement accounts have a different relationship with their broker-dealer depending on the account for which they are seeking advice. The DOL rule was vacated by the Fifth Circuit Court of Appeals in March 2018.[10] The DOL rule is no longer effective.

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[3] *See, e.g.*, FINRA Rules 2010 (Standards of Commercial Honor and Principles of Trade), 2111.01 (Suitability), and 2121 (Fair Prices and Commissions).
[4] *See, e.g.*, Exchange Act § 10(b) (anti-fraud provision); Richard Cea, et al., 44 S.E.C. 8662 (1969).
[5] *See, e.g.*, Regulation Best Interest, 83 Fed. Reg. at 21,577 n.15 (collecting cases).
[6] Fiduciary Rule, 81 Fed. Reg. 20,946 (Apr. 8, 2016).
[7] *See* Fiduciary Rule, 81 Fed. Reg. at 20,954 (prior standard for establishing when "investment advice" had been given to an ERISA plan or individual retirement account), 29 C.F.R. § 2510.3-21(a) (new standard).
[8] 29 U.S.C. § 1106, 26 U.S.C. § 4975(c) & (e)(2).
[9] Best Interest Contract Exemption, 81 Fed. Reg. 21,002, 21,076–79, 21,133–38; Letter from Marc R. Bryant, Senior Vice President, Fidelity Investments, to Jay Clayton, Chairman, S.E.C. (Aug. 11, 2017) (noting the "onerous" requirements of the DOL rule)
[10] *Chamber of Commerce of the U.S.A., et al. v. U.S. Dep't of Labor, et al.*, No. 17-10238 (5th Cir. Mar. 15, 2018).

Regulation Best Interest

Regulation Best Interest would provide that when a broker-dealer[11] makes a securities transaction recommendation or an investment strategy recommendation, the broker-dealer must act in the "best interest" of the retail customer at the time the recommendation is made without putting its financial or other interests ahead of the interest of the retail customer.[12] Regulation Best Interest does not define what it means to act in the "best interest" of a retail customer. Instead, it outlines three obligations that must be met to satisfy the "best interest standard".[13]

First, prior to or at the time of a recommendation, the broker-dealer must reasonably disclose the material facts relating to the scope and terms of the relationship with the retail customer, including all material conflicts of interest associated with the recommendation.[14]

Second, the broker-dealer must exercise reasonable diligence, care, skill, and prudence to: (a) understand the potential risks and rewards associated with a recommendation and have a reasonable basis to believe a recommendation could be in the best interest of at least some retail customers; (b) have a reasonable basis to believe that a recommendation is in the best interest of a particular retail customer based on his or her investment profile and the potential risks and rewards associated with a recommendation; and (c) have a reasonable basis to believe that a series of recommended transactions is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile.[15]

Third, the broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to identify and at a minimum disclose all material conflicts of interest associated with the recommendation.[16] In addition, these policies and procedures must also be reasonably designed to mitigate material conflicts of interests arising from financial incentives associated with the recommendation.[17]

The CRS Relationship Summary

The CRS Relationship Summary proposal also would enhance disclosure to retail investors. First, broker-dealers and investment advisers would be required to provide a written summary to retail investors at the beginning of a relationship with a firm informing them of: the relationship and services the firm offers; the applicable standard of conduct; the fees and costs associated with the services; specified conflicts of interest; and whether the firm or its financial professionals have reportable legal or disciplinary events.[18] Second,

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[11] For simplicity, we refer throughout the letter to "broker-dealers." Regulation Best Interest applies to broker-dealers and any "natural person who is an associated person" of a broker-dealer.
[12] Regulation Best Interest, 83 Fed. Reg. at 21,681.
[13] *Id.* at 21,681–82.
[14] *Id.* at 21,681.
[15] *Id.* at 21,681–82.
[16] *Id.* at 21,682.
[17] *Id.*
[18] Form CRS Relationship Summary, 83 Fed. Reg. at 21,416.

broker-dealers and associated natural persons will be prohibited from using the terms "advisor" or "adviser" when communicating with retail investors.[19] Third, broker-dealers and investment advisers will be required to disclose their registration status in retail investor communications.[20]

The Committee Commends the SEC's Efforts

As we have stated in the past, the Committee supports adoption of a "best interest" standard.[21] Furthermore, we agree with others that because the SEC is the primary securities market regulator with expertise and experience in regulating broker-dealers, the SEC should be the agency that takes the lead in regulating broker-dealer conduct.[22] Given the Fifth Circuit's recent vacatur of the DOL's "fiduciary rule,"[23] this is the appropriate time for the SEC to be considering this initiative.

The Committee also commends specific aspects of the SEC's Proposals. One positive attribute of the Proposals is that they should result in reduced retail customer confusion. Unlike the DOL's fiduciary rule, which only applied to certain types of brokerage accounts, the SEC's Regulation Best Interest proposal applies to all broker-dealers. Thus, under the SEC's proposal, retail customers will have consistent relationships with their broker-dealer across different account types. In addition, the Proposals' disclosure requirements will provide retail customers with enhanced information regarding the standard of conduct owed to them by their broker-dealer.

Another commendable aspect of the Regulation Best Interest proposal is that it is principles-based. A few specific examples of how a principles-based approach is beneficial are illustrative.

First, the best interest obligation under the Proposals requires that the broker-dealer act in the retail customer's best interest "without placing the financial or other interest" of

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[19] *Id.* at 21,546.
[20] *Id.*
[21] Comm. on Cap. Mkts. Reg., Comment Letter on Proposed Rule to Redefine the Term "Fiduciary" Under the Employee Retirement Income Security Act of 1974 at 4 (Sept. 24, 2015), https://www.capmktsreg.org/wp-content/uploads/2015/09/9-24-15.CCMR_.DOL_.Rule_.Comments.pdf. Others have also supported adoption of a "best interest standard." *See, e.g.*, Securities Industry and Financial Markets Association, Comment Letter on Standards of Conduct for Investment Advisers and Broker-Dealers (July 21, 2017), https://www.sifma.org/wp-content/uploads/2017/07/Letter-to-SEC.pdf; Vanguard, Comment Letter on Standards of Conduct for Investment Advisers and Broker-Dealers (Sept. 29, 2017), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2614762-161147.pdf.
[22] *See, e.g.*, Blackrock, Comment Letter on Standards of Conduct for Investment Advisors and Broker-Dealers 2 (Aug. 7, 2017), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2189134-160256.pdf ("The SEC is better positioned to create a consistent compliance regime for brokerage and advisory accounts, which would result in greater choice for investors based on their individual needs and objectives"); Fidelity, Comment Letter on Proposed Rule on Standards of Conduct for Investment Advisers and Broker-Dealers 2 (Aug. 11, 2017), https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2216673-160638.pdf ("We believe that the SEC, as the primary regulator of investment advisers and broker-dealers, should take the lead role in reviewing standards of conduct . . . .").
[23] *Chamber of Commerce*, No. 17-10238, *supra* n.10.

the broker-dealer ahead of the interest of the retail customer.[24] This contrasts with the DOL approach, which required broker-dealers to provide advice "without regard" to any of its interests.[25] That stringent requirement, along with other onerous ones in the DOL "fiduciary rule" had a deleterious effect on customer access to broker-dealer advice. For example, a SIFMA survey of firms on the impact of the DOL rule found that 53% of firms eliminated access to brokerage accounts in which a customer could be provided investment advice or increased the account minimum required to be able to receive advice.[26] These changes meant that to retain the ability to receive advice, over 10 million accounts with $900 billion in assets under management would have to move to a fee-based account option.[27]

Second, because the SEC's Regulation Best Interest proposal is not prescriptive and permits broker-dealers to offer commission-based accounts as long as reasonable disclosure, care, and conflict mitigation obligations are satisfied, the SEC's proposal does not evince bias against commission-based accounts. As a result, retail customers would retain the ability to choose commission-based accounts.[28] Access to commission-based accounts is important because for some retail customers, such as those who use a buy-and-hold investment approach, a commission-based account is more cost-effective than the alternative of a fee-based account in which fees are collected from a percentage of the assets in a customer's account.[29]

Third, the principles-based approach also provides flexibility in how firms can achieve compliance under the best interest standard. For example, under the disclosure obligation requirement, broker-dealers are required to "reasonably disclose[]" "material facts" about the scope and terms of the relationship and the "material conflicts of interest."[30] These terms are not defined in the rule, but the "reasonable" standard will provide flexibility to firms in deciding how to make necessary disclosures. It also imposes a negligence-type standard, which ensures that a violation or liability will not be triggered for a mere technical violation of a prescriptive standard.

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[24] Regulation Best Interest, 83 Fed. Reg. at 21,681.
[25] Best Interest Contract Exemption, 81 Fed. Reg. at 21,083.
[26] SIFMA, The DOL Fiduciary Rule's Negative Impact on Retirement Savers; Deloitte, The DOL Fiduciary Rule: A Study on How Financial Institutions Have Responded and the Resulting Impact on Retirement Investors 11 (2017), https://www.sifma.org/wp-content/uploads/2017/08/Deloitte-White-Paper-on-the-DOL-Fiduciary-Rule-August-2017.pdf.
[27] SIFMA, The DOL Fiduciary Rule's Negative Impact on Retirement Savers, https://www.sifma.org/wp-content/uploads/2017/08/DOL-Study-Infographic-August-2017.pdf; Deloitte & Touche LLP, The DOL Fiduciary Rule: A Study on How Financial Institutions Have Responded and the Resulting Impact on Retirement Investors 12 (Aug. 9, 2017), https://www.sifma.org/wp-content/uploads/2017/08/Deloitte-White-Paper-on-the-DOL-Fiduciary-Rule-August-2017.pdf.
[28] *Impact of the DOL Fiduciary Rule on the Capital Markets: Hearing Before the Capital Markets, Securities, and Investment Subcomm. of the H. Comm. on Financial Services*, 2 (July 13, 2017) (statement of Douglas Holtz-Eakin, President, American Action Forum) ("In 2011, a survey of 25.3 million IRA accounts found that a large majority of IRA investors opted for commission-based instead of fee-based arrangements.").
[29] *Id.* at 3–4 (citing studies that fee-based accounts yield more than 50 percent more revenue for firms than commission-based accounts and that advisors earn more than 60 basis points more on fee-based accounts than commission-based accounts).
[30] Regulation Best Interest, 83 Fed. Reg. at 21,681.

Similarly, we approve of the "reasonableness" standard that is also incorporated into the aspect of the best interest rule under which broker-dealers will have to exercise reasonable diligence, care, skill, and prudence in determining if a recommendation is in a retail customer's best interest. Likewise, the obligation to establish, maintain, and enforce policies and procedures to identify, disclose, and in some cases, mitigate or eliminate material conflicts of interest appropriately is subject to a reasonableness standard.

The Committee's Concerns

While the Committee commends the SEC's efforts and general approach, we do have some concerns that we wish to raise.

First, we think that the SEC should be cognizant of the fact that the principles-based nature of the Regulation Best Interest proposal creates some ambiguity in the proposed rule and subjects it to differing interpretations based on particular facts and circumstances and differing interpretations over time. This exposes regulated parties to the risk that they could be found to be in violation of the rule despite good faith efforts at compliance and without being on notice about the wrongfulness of their conduct.

One example of where this problem can be found is in Regulation Best Interest's requirement that broker-dealers' policies and procedures be reasonably designed to disclose and "mitigate" material conflicts of interest arising from financial incentives.[31] The rule does not define what it means to reasonably "mitigate" such conflicts. Would obtaining a customer's informed consent constitute sufficient mitigation? Or would other steps need to be taken? Generally, investment advisers have been able to resolve conflicts of interest through disclosure and customer consent.[32] There are not obvious reasons why broker-dealers should be subjected to higher standards with respect to conflicts of interest than investment advisers, but the proposed rule could be interpreted to do so. The ambiguity about what constitutes sufficient "mitigation" could also lead to differing requirements over time. That is because different people at different times, including SEC commissioners, may take divergent views on whether particular policies and procedures sufficiently mitigated such conflicts.

We are concerned that ambiguity inherent in the proposed Regulation Best Interest could create uncertainty for broker-dealers. And we are particularly concerned that the SEC could end up engaging in regulation by enforcement where it announces new standards not explicitly or unambiguously set forth in the rule through enforcement proceedings.

To mitigate these concerns, we believe that the SEC should commit to working collaboratively with broker-dealers to provide guidance, insight, and informal feedback on the appropriateness of firms' policies and procedures as they are developed and

[31] *Id.* at 21,682.

[32] Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 83 Fed. Reg. 21,203, 21,205 (May 9, 2018) (stating that an investment adviser and customer may shape the fiduciary relationship "through contract when the client receives full and fair disclosure and provides informed consent"); *id.* at 21,208 (referencing disclosure and consent as a way to avoid conflicts of interest with clients).

implemented. We recommend that the SEC make clear that financial conflicts of interest can be mitigated by obtaining a retail customer's consent to the extent that the broker-dealer has provided disclosure about the specific conflict that is understandable and allows the retail customer to provide informed consent. More generally, the SEC can provide appropriate guidance and insight by giving feedback when conducting supervisory examinations, establishing open channels of communication for firms to contact the SEC with questions, and issuing FAQs or other interpretative guidance, including reports of investigation under Section 21(a) of the Securities Exchange Act of 1934.[33] Of course, we support robust enforcement of Regulation Best Interest where a violation is clear.

Second, the SEC should ensure that the disclosures required under the Form CRS Relationship Summary proposals are simple and easy to understand. We agree with Commissioner Piwowar's concern that the 4-page sample disclosures provided in the release[34] are not pitched to the ordinary retail investor. As he noted in his statement, "the Flesch-Kincaid readability calculator shows that they are about as comprehensible to the average reader as Herman Melville's *Moby Dick*."[35] Disclosure that is not comprehensible to retail investors imposes compliance costs on firms without concomitant benefits.

The SEC should consider if there are ways to simplify and shorten the disclosure. For example, the SEC should explore whether it would be feasible to provide a one-page disclosure with a link to a webpage with more detailed or additional disclosures. The SEC's release noted that it considered a one-page disclosure option, but did not think it would convey sufficient information.[36] The release, however, did not state that the SEC considered a short disclosure document with required supplemental disclosures provided online.

Finally, to the extent the DOL seeks to implement a revised fiduciary rule in light of the 5th Circuit's decision, any DOL rule should be harmonized with the SEC's Proposals.[37] Specifically, we believe that broker-dealers that comply with the SEC's Proposals should be exempt from prohibited transaction restrictions arising under any DOL regulation of broker-dealers.

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[33] Section 21(a) allows the SEC to publish information concerning violations of federal securities laws and regulations that arise from an investigation even where the SEC has determined not to pursue an enforcement action against the violator.

[34] *See, e.g.*, Form CRS Relationship Summary, 83 Fed. Reg. at 21,559–62.

[35] Michael S. Piwowar, Commissioner, U.S. Sec. & Exch. Comm'n, Statement at Open Meeting on Form CRS, Proposed Regulation Best Interest and Notice of Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers (Proposed Rule) (Apr. 18, 2018), https://www.sec.gov/news/public-statement/statement-piwowar-041818.

[36] Form CRS Relationship Summary, 83 Fed. Reg. at 21,421, 21,498–99.

[37] Others have previously made similar requests. *See, e.g.*, SIFMA Letter, *supra* n.21, at 8; Vanguard Letter, *supra* n.21, at 6–7.

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Thank you very much for your consideration of our views. Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott (hscott@law.harvard.edu), or Deputy Director, John Gulliver (jgulliver@capmktsreg.org), at your convenience.

Respectfully submitted,

John L. Thornton	Hal S. Scott	R. Glenn Hubbard
Co-CHAIR	DIRECTOR	Co-CHAIR

cc:

United States Department of Labor
The Honorable Alexander Acosta, Secretary