



August 6, 2018

Via Email rule-comments@sec.gov

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Proposed Regulation Best Interest /File #S7-07-18

Dear Secretary Fields:

I am providing these comments with respect to proposed Regulation Best Interest on behalf of Incapital LLC ("Incapital" or "we"), a registered broker-dealer headquartered in Chicago, Illinois.

About Incapital

Incapital is a wholesale broker-dealer that primarily assists seasoned issuers and well-known seasoned issuers of registered retail medium-term corporate note and structured note offerings in the offer, sale and distribution of such securities on a weekly basis, and distributes such securities offerings through a network of 600+ broker-dealers. In connection with our distribution of such securities, we sell the securities directly to dealer sales desk personnel, and primarily sell wholesale structured medium-term corporate notes to registered representatives at various bank-affiliated and regional broker-dealers. We provide product education and training to registered representatives to support the sales of such structured securities to the retail customers of the bank-affiliated and regional broker-dealers that are part of our network. In this comment letter, Incapital focuses principally on the application of proposed Regulation Best Interest in relation to new issue retail debt offerings.

Discussion

At the outset, we commend and applaud the Securities and Exchange Commission (the "Commission") for its efforts to address and mitigate potential and actual conflicts of interest by proposing Regulation Best Interest. From our perspective, proposed Regulation Best Interest: can be more easily understood than the Fiduciary Duty Rule that had been promulgated by the Department of Labor ("DOL"); requires that broker-dealers undertake certain steps in order to ensure compliance with the Rule but these can be implemented on a more cost-effective basis compared to the measures that had been required by the DOL's rule; appropriately addresses retail investor protection concerns; sets forth a single standard that applies to both taxable and non-taxable accounts; and, importantly, preserves the broker-dealer point-of-sale, commission-based transaction model that is better suited for certain retail customers who are primarily buy and hold investors.



In recent years, the financial services industry has witnessed significant changes. There has been an unprecedented migration of registered representatives and retail accounts departing broker-dealers to join independent registered investment advisers (“RIAs”). Numerous financial services firms have exited or limited their broker-dealer operations in favor of a fee-based advisory model. The exodus from a broker-dealer model to an RIA model was spurred by a variety of factors, including a compression of broker-dealer payouts and representative compensation, increased regulation and regulatory scrutiny of broker-dealers and a desire by both firms and registered representatives to capture a recurring and more predictable level of asset-based fee revenue.

In many instances, retail broker-dealer customers were encouraged to move their account(s) to RIAs or to advisory affiliates of broker-dealers based on the premise that they would obtain professional money management and portfolio monitoring services. However, retail clients who have moved from a traditional broker-dealer point-of-sale commission-based transaction model may have existing investments in, or be invested in, packaged products, such as mutual funds. Such managed products tend to be “buy and hold” investments. Likewise, retail clients who move to a fee-based account may journal or transfer existing securities into the new account and, to avoid capital gains, those securities may not be sold and may become part of the managed account. Such retail clients have likely paid more in fees than they otherwise would have paid if they simply maintained a traditional broker-dealer account. Conversely, other retail customers have benefited from professional asset management and portfolio monitoring services. In this regard, the Commission should consider enhancing the standards applicable to RIAs when RIAs solicit a client to open an advisory account from an existing brokerage account or rollover assets from a 401k account. We believe that the RIA should be required to provide the retail customer with a written illustration of the fees the retail customer has historically paid and those that it will pay with respect to an advisory account.

Regardless, the DOL Fiduciary Rule established artificial “roadblocks,” which had an intended or unintended effect of driving additional broker-dealer retail accounts to RIAs and advisory affiliates, as evidenced by broker-dealers terminating traditional broker-dealer models in favor of a fee-based advisory account model. As the Commission seeks to implement Regulation Best Interest, it is imperative that any new “best interest” standard and corresponding regulations foster and encourage maintenance of the traditional broker-dealer commission model.

As referenced above, a factor in the decision to create a fee-based advisory platform or become an advisory representative is the difference in licensing and financial responsibility requirements applicable to broker-dealers. Given the lack of testing requirements for advisory representatives who make discretionary investment decisions on behalf of their clients, we believe that RIA advisory representatives should be subject to licensing qualifications to, at a minimum, ensure their comprehension of the fiduciary standards that govern their conduct. Likewise, given the lack of any capital requirements for RIAs, we further believe that RIAs should be subject to reasonable financial responsibility obligations, including an obligation to maintain a level of reserve capital and/or fidelity bond coverage to protect against employee theft and similar



misconduct. In that regard, we believe additional rulemaking relating to the regulation of RIAs by the Commission is warranted.

As mentioned above and discussed in further detail below, proposed Regulation Best Interest makes no reference to new issue securities. We believe any “best interest” standard should codify a safe harbor provision in relation to the offer and sale of new issue debt securities. Historically, the debt markets have favored large institutional purchasers for which issuers could execute a global note offering and ensure that the offering is sold quickly to a small segment of large institutional buyers. Large institutional buyers, which include mutual funds registered under the Investment Company Act of 1940 (the “1940 Act”) and ETFs, hedge funds and bulge bracket firms have been able to routinely purchase entire new issue debt offerings with minimal to no allocations being earmarked for retail investors.

Incapital was founded in order to make new issue debt securities readily available to retail customers. The retail notes sold by issuers through Incapital have smaller denominations and typically include a survivor’s option provision, which allows a beneficiary to put a note back to the issuer of the note at the owner’s time of death. Retail notes are offered by issuers on a weekly basis pursuant to the issuers’ existing shelf registration statement. In order to facilitate retail investor participation in new issue debt offerings, we believe it is important for the Commission to remove any obstacles in relation to the offer and sale of new issue debt securities to retail investors and to take steps to foster a robust retail debt securities new issuance market.

Proposed Regulation Best Interest fails to define the term “best interest” and fails to outline the types of measures required to ensure compliance with the proposed best interest standard. In a new issue debt securities offering, typically registered representatives are compensated through a corresponding payout on a new issue sales concession associated with an offering. We believe that the Commission should codify the fact that new issue securities being sold to wrap-fee or fee-based advisory accounts may be sold to such accounts net of the sales concession (subject to the broker-dealer charging a ticket fee or commission if such broker-dealer is acting as a custodial and/or executing broker for such account).¹ The inclusion of such a provision will address what may erroneously be viewed as a “conflict of interest,” and will encourage sales of new issue debt securities to fee-based and wrap fee accounts.

The Commission should take into account that, as a result of proposed Regulation Best Interest, broker-dealers may eliminate sales of new issue debt securities in their entirety because these entail the receipt of a sales concession or that broker-dealers may no longer offer particular new issue securities offerings based on the amount of the corresponding sales concession. For example if a broker-dealer has an ability to purchase for its retail customers three (3) separate

¹ Historically, issuers have included fee disclosures in the applicable pricing supplement or other disclosure document (e.g., “Plan of Distribution” section of a prospectus) whereby, as an example, the disclosure states that fee-based accounts can purchase net of the sales concession. Such disclosure makes sense as a fee-based account pays a management fee in relation to the account. However, not all issuers include such disclosures and the disclosure language differs among issuers.



\$25 par, 3.5% coupon, 5-year, no-call two-year, medium-term, [asset-backed] corporate notes, with corresponding sales concessions of \$0.30, \$0.35, and \$0.40, how does the broker-dealer manage a potential conflict related to the differential in compensation? Add to that example that the first note is issued by a cyclical retailer in a down cycle, the second note is issued by a manufacturer in a flat market environment and the third note is issued by a technology company in an expanding tech-based economic environment. Is the broker-dealer acting in its retail customer's best interest if it opts to purchase the debt security that pays the largest sales concession? We believe these types of evaluations will affect the review process by broker-dealers in determining which products to offer to retail investors. In that example, a broker-dealer could elect to simply purchase the debt security with the lowest sales concession, which is arguably not in the client's best interest given the prevailing economic environment related to that particular issuer.

As the Commission evaluates this issue, it should be noted that sales concessions are clearly disclosed to retail investors in the offering documents. In order to maintain a robust new issue debt security market for retail investors, we believe Regulation Best Interest should contain a safe harbor provision that provides in effect a materiality standard that will enumerate the relevant factors that a broker-dealer should consider when recommending a particular new issue debt instrument to a retail customer. Moreover, the Commission should distinguish between new issue offerings and securities purchased in the secondary market.

In addition, we believe that proposed Regulation Best Interest creates artificial obstacles in relation to the sale of market-linked or structured investments. Proposed Regulation Best Interest could be construed to effectively follow FINRA Notice to Members 12-03 concerning Complex Products. NTM 12-03 states in relevant part as follows:

Consideration of Whether Less Complex or Costly Products Could Achieve the Same Objectives for the Customer. Registered representatives should consider whether less complex or costly products could achieve the same objectives for their customers. For example, registered representatives should compare a structured product with embedded options to the same strategy through multiple financial instruments on the open market, even with any possible advantages of purchasing a single product.

We believe that any standard tied primarily to the cost of a particular market-linked or structured product will potentially and adversely limit the scope of investment products available to retail customers. Historically, access to structured products was limited to wealthy or high net worth investors. Over time, structured products have become available to mainstream investors particularly as compliance concerns with respect to such products have been addressed over time. To retain the important benefits that structured products and other similar products offer to retail investors, we believe that cost alone should not be a determinative factor in assessing whether there exists a potential conflicts of interest. Instead, Regulation Best Interest should set forth a "totality of the circumstances" test such that broker-dealers' recommendations in the best

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interest of their retail customers will be judged based upon the totality of the circumstances and all relevant facts applied to the retail customer, including their risk profile, investment objectives, financial capabilities and level of sophistication.

While our perspectives and comments in this letter are effectively limited to new issue debt securities, we believe the same principles likely apply to new issue equity securities as well.

We appreciate this opportunity to share our thoughts with the Commission. Once again, we applaud the Commission for its thoughtful efforts to protect retail investors and set forth standards that ensure retail investors are provided continued access to a traditional broker-dealer point-of-sale commission model and given access to the full array of new issue and secondary market securities as well as access to market-linked or structured investments.

Thank you for considering Incapital's comments.

Sincerely,
Incapital LLC

A. Brad Busscher
Chief Administrative Officer and General Counsel