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August 6, 2018

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Regulation Best Interest, S7-07-18; Form CRS Relationship Summary, S7-08-18; Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, S7-09-18

Dear Chairman Clayton:

Thank you for efforts to advance investor education and to improve the marketplace in raising the professional standards of conduct for registered representatives and securities broker-dealers. Please know that we fully appreciate the challenges and legal complexities of developing a different standard for broker-dealers and agents in a marketplace where many customers desire and have chosen the efficiency of transaction-based professional services.

The Iowa Insurance Division regulates the solvency and conduct of Iowa based insurance companies writing annuities and insurance contracts throughout the United States and around the globe. We also license and regulate the competence and conduct of thousands of insurance producers writing business in and from the state of Iowa. Finally, we serve as the state securities regulator through our Iowa Securities Bureau, with authority over the professional competence and conduct of thousands of securities agents and investment adviser representatives, and hundreds of broker-dealers and state-covered investment advisers.

These comments are expressed from the perspective as both a state securities regulator and an insurance regulator. As you may know, Iowa's Uniform Securities Act¹ is complementary to federal law and utilizes many of the common regulatory principles, including the current FINRA standards for suitability, supervisory controls and investment advisers' fiduciary obligations. Our Securities Bureau annually investigates securities complaints and conducts examinations of agents and investment advisers. Under Iowa's Insurance Trade Practices Act², Iowa adopted the NAIC's *Suitability in Annuity Transactions Model Regulation* (#275)³ ("the Annuity Suitability model"). Our Enforcement Bureau prosecutes

¹ Iowa's Uniform Securities Act is codified in Chapter 502.

² Iowa's Insurance Trade Practices Act is codified in Chapter 507B, a model state law originally developed in 1945 from the Federal Trade Commission Act.

³ This model is codified in Iowa Administrative Code rules 191—15.72 – 15.87. The Annuity Suitability model has been widely adopted by the states and was recognized in Congress' adoption of Section 989J of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). Section 989J confirmed the exemption of certain annuities from the Securities Act of 1933 and confirmed state regulatory authority over fixed and fixed index annuities.

administrative enforcement actions against both insurance and investment professionals and issuers, seeking the suspension or revocation of professionals' registrations, imposition of fines and the order of restitution. These efforts effectively deter unprofessional, unethical and unlawful market conduct across the insurance and investment markets.

We write today regarding the proposed rulemaking package published May 9, 2018 by the U.S. Securities and Exchange Commission (SEC). The proposed rulemaking package included Regulation Best Interest⁴; Form CRS Relationship Summary⁵ ("Relationship Summary Proposal"); and Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers⁶ ("Proposed Investment Adviser Interpretation").

Our central concern about your proposed rulemaking is the elimination of "suitable" from the text of Regulation Best Interest. We have found no congressional instruction in statute requiring disposal of "suitability" in the Dodd-Frank Act, especially in light of Section 989J. Section 913(g)(2) of the Dodd-Frank Act directs the Securities and Exchange Commission to consider developing a "best interest" standard of care for "all brokers, dealers and investment advisers, when providing personalized investment advice. . . ." But this does not require and should not result in the disposal of "suitability" (and its rich jurisprudence) as a core component of any enhanced broker-dealer standard of care.

Disposal of "suitability" actually conflicts with developments in investment adviser jurisprudence and regulation, which rely heavily on "suitability." For years, we have applied "suitability" as a core component in our routine examinations of state-covered investment advisers. This approach is even well recognized in the SEC's Proposed Investment Adviser Interpretation. Investor protection will not be advanced by striking well-developed concepts of "know your customer" and "suitability" from the express language of the broker-dealers' and agents' professional obligations.

In an apparent effort to create two distinct "best interest" standards, the language of the proposed Regulation Best Interest attempts to distinguish a securities agent's "best interest obligation" from an investment adviser's "best interest obligation." The SEC exhibits its own confusion concerning the interaction between "suitability" and "best interest" in its Proposed Investment Adviser Interpretation, where on page 11 it states: "An investment adviser must also have a reasonable belief that the personalized advice is suitable for and in the best interest of the client based on the client's investment profile."⁷

The inclusion of suitability as a component of an investment adviser's obligation is historical and carefully noted in footnote 25 of the Proposed Investment Adviser Interpretation:

⁴ Regulation Best Interest, 83 Fed. Reg. 21574 (proposed May 9, 2018) (to be codified at 17 C.F.R. pt. 240).

⁵ Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles, 83 Fed. Reg. 21416 (proposed May 9, 2018) (to be codified at 17 C.F.R. pts. 240, 249, 275 and 279).

⁶ Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, 83 Fed. Reg. 21203 (proposed May 9, 2018) (to be codified at 17 C.F.R. pt. 275).

⁷ *Id.* at 21206 (emphasis added).

See, e.g., Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients, Investment Advisers Act Release No. 1406 (Mar. 16, 1994) (“Investment Advisers Act Release 1406”) (stating that advisers have a duty of care and discussing advisers’ suitability obligations);⁸

The premise of disposing the term “suitable” from the text of Regulation Best Interest is mysterious given its continual prominence when describing an investment adviser’s obligations in footnote 26 of the Proposed Investment Adviser Interpretation, which states:

In 1994, the Commission proposed a rule that would make express the fiduciary obligation of investment advisers to make only suitable recommendations to a client. Investment Advisers Act Release 1406, *supra* note 25. Although never adopted, the rule was designed, among other things, to reflect the Commission’s interpretation of an adviser’s existing suitability obligation under the Advisers Act. We believe that this obligation, when combined with an adviser’s fiduciary duty to act in the best interest of its client, requires an adviser to provide investment advice that is suitable for *and in the best interest of* its client.⁹

These footnotes make clear that an investment adviser has the obligation to make a suitable recommendation and one that is in the best interest of the client. If the obligations of a broker-dealer and agent are different from those of an investment adviser, and we believe that is the intent, then it is a mistake to use identical language to name a distinct obligation. In contrast to an investment adviser who is a fiduciary under the terms of a contract, we must conclude that the SEC intends to redefine “best interest” in the context of a securities agent’s recommendation to be “know your customer” and “suitability” plus (1) disclosure and customer comprehension of the professional’s role and relationship to the customer in the recommended transaction, and (2) disclosure and customer comprehension of the professional’s compensation, financial incentives and material conflicts of interest. Striking “suitability,” and its history and legal precedence, will usher in an age of legal and marketing confusion. Additionally, smaller and mid-sized professional firms, to avoid the risks of this confusion and the resulting litigation, will leave the market, and the larger firms will remain, increasing market concentration. A decision to replace the term “suitable” in the text of traditional suitability rules with the phrase “best interest” will disrupt the market, decrease competition, increase the price of services out of the reach of thousands of middle class Americans, and significantly reduce consumer options for selecting valuable professional services.

“Best Interest” is not distinct from “Best Interest”

The concept of “best interest” is closely intertwined with a fiduciary’s obligations to the principal under Iowa law. Under Iowa jurisprudence and statutes, “best interest” or “best interests” has varied purposes and meanings dependent upon the particulars of the fiduciary obligation, but the “best interest obligation” is always fundamental to fiduciary duties.¹⁰

⁸ *Id.*

⁹ *Id.* (emphasis in original).

¹⁰ *See Stotts v. Eveleth*, 688 N.W.2d 803 (Iowa 2004) (fiduciary duties of teacher to student); *In re Guardianship and Conservatorship of Jordan*, 616 N.W.2d 553 (Iowa 2000) (fiduciary duties of a guardian and conservator to a ward); *In re*

The Release for proposed Regulation Best Interest seeks to distinguish “best interest” from “fiduciary,” but the actual proposed regulation makes no textual distinction, leaving industry and regulators in the midst of great uncertainty.

The opening paragraph of § 240.151-1(a) of the proposed Regulation Best Interest states:

(a) *Best Interest Obligation.* (1) A broker, dealer, or a natural person who is an associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer, shall act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.¹¹

This section is likely to be the foundation for most agent and broker-dealer disciplinary actions involving inappropriate recommendations. State courts in enforcement actions and in review of such actions may find it difficult to distinguish this transactional “know your customer best interest obligation” from an investment adviser fiduciary “best interest” standard and its attendant duties of skill and loyalty. A securities registered representative with a Series 6 registration offering proprietary equity mutual funds “off the shelf” will likely shy away from the risks of litigation in this regulatory environment, causing a substantial market contraction away from middle class investors. The SEC in its advisories can try to explain the duty of loyalty is not included in this newly announced “best interest” standard, because it is fully met by compensation and relationship disclosures, but this distinction from the Investment Adviser duty is not clear in the text of proposed Regulation Best Interest. Further, the skill of a Series 6 securities agent obviously differs from a Series 7 general securities agent and the proposed Regulation Best Interest does not make a clear distinction.

“Best Interest” as a Process

The SEC describes the new “best interest” as a process. This is seemingly explained in proposed § 240.151-1(a) by establishing elements to satisfy this “best interest obligation”:

(2) The best interest obligation in paragraph (a)(1) shall be satisfied if:

(i) *Disclosure Obligation.* The broker, dealer, or natural person who is an associated person of a broker or dealer, prior to or at the time of such recommendation, reasonably discloses to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer, including all material conflicts of interest that are associated with the recommendation.

(ii) *Care Obligation.* The broker, dealer, or natural person who is an associated person of a broker or dealer, in making the recommendation exercises reasonable diligence, care, skill, and prudence to:

Estate of Crabtree, 550 N.W.2d 168 (Iowa 1996) (fiduciary duties under power of attorney of principal to agent); *Cookies Food Products, Inc. v. Lakes Warehouse Distributing, Inc.*, 430 N.W.2d 447 (Iowa 1988) (fiduciary duties of officer and director to corporation).

¹¹ Regulation Best Interest, 83 Fed. Reg. at 21681.

(A) Understand the potential risks and rewards associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers;

(B) Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks and rewards associated with the recommendation; and

(C) Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile.

(iii) *Conflict of Interest Obligations.*

(A) The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendations.

(B) A broker, dealer, or a natural person who is an associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer, shall act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.¹²

Although the text of paragraph 2 appears to set out obligations which taken together add up to the "best interest" obligation set forth in paragraph 1, it does so using the very same language it purports to define. Subparagraphs 2(ii)(A) and (B) require that the recommendation "could be in the best interest of at least some retail customers" and "is in the best interest of a particular retail customer." This circular language provides no additional clarity to the standard of a broker-dealer in the context of making a recommendation. If "best interest" is meant to be satisfied by the performance of specified elements including the disclosure of role, compensation, and conflicts of interest, these elements should be used to clearly define the new obligation. To do otherwise would appear to be a circular, meaningless exercise.

Furthermore, the general "best interest" requirement for "some retail customers" in subparagraph 2(ii)(A) is rendered meaningless by the more specific "best interest of a particular retail customer" of subparagraph 2(ii)(B), which is focused on a particular retail customer's profile. The general requirement outlined in 2(ii)(A) that the recommendation is in the best interest of some retail customers is meaningless and contributes nothing to the ultimate decision of whether or not the recommendation is in the best interest of the specific customer, which has historically been the aim of fiduciary and suitability standards. The fact that a recommendation may be in the best interest of some retail customers, with different customer profiles and goals, is irrelevant. As a state regulator ultimately charged with enforcing this regulation, we may find it necessary to conclude that the SEC actually intended the phrase "best interest" in subparagraph 2(ii) in its current form to mean "suitable." Since we have the valuable precedence of suitability, we believe that suitability should be retained in the text of the Care Obligation.

For all of the above reasons, we recommend that the SEC use the term "suitable" in lieu of the phrase "best interest" in all parts of the Care Obligation found in subparagraph (ii) of paragraph (2).

¹² *Id.* at 21681-21682.

Customer Relationship Summary

This effort may be the most important component of the SEC's efforts to increase financial literacy of customers. We fully support the development of a customer relationship summary that explains the distinct roles, relationship structure, and services as well as identifying the various means of compensation broker-dealers and investment advisers may receive. Meaningful disclosure, such that is readily comprehended by retail customers, can be an effective tool to clarify the distinction between broker-dealers and investment advisers. We would caution against being overly proscriptive regarding the form and content of the summary as this may inadvertently result in less effective disclosures. The form should also offer links to webpages of trusted resources including the SEC, FINRA, and the National Association of Insurance Commissioners to offer additional investor education.

The supervisory systems of broker-dealers and investment advisers will need to include controls and procedures that test for and regularly evaluate customer comprehension. We look forward to continuing to work with the SEC and offering comment as this work develops.

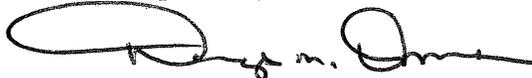
Investment Adviser

The Proposed Investment Adviser Interpretation seeks to “reaffirm—and in some cases clarify—certain aspects of the fiduciary duty that an investment adviser owes to its clients under section 206 of the Advisers Act.”¹³ As “[t]his fiduciary standard is based on equitable common law principals”¹⁴ it is unclear what the benefits of an SEC restatement of the standard would be. The standard has developed through common law, and as such, any continued development by common law may be preferable. Footnote 7 of the commentary points out the limitation of this restatement as the “Release is intended to highlight the principles relevant to an adviser’s fiduciary duty. It is not, however, intended to be the exclusive source for understanding these principles.”¹⁵ A restatement of the standard based upon the views of the current SEC¹⁶ would only seem to question and diminish the existing common law standard instead of clarify it.

Conclusion

We look forward to continuing our ongoing dialogue as we continue to consider this important but complex issue. Should you have any questions, do not hesitate to contact me at [REDACTED].

Respectfully,



Douglas M. Ommen
Iowa Insurance Commissioner

¹³ Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 83 Fed. Reg. at 21204.

¹⁴ *Id.* at 21205.

¹⁵ *Id.* at 21204.

¹⁶ *Id.* at 21206.