



August 2, 2018

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

RE: File No. S7-07-18; Release No. 34-83062, *Proposed Regulation Best Interest*; and File No. S7-08-18; Release No. 34-83063, *Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles*

Dear Mr. Fields:

The University of Miami School of Law Investor Rights Clinic (the “IRC”)¹ appreciates the opportunity to comment on the Securities and Exchange Commission’s (the “Commission” or “SEC”) proposed *Regulation Best Interest* (“Reg BI”)² and accompanying proposed rule requiring the provision of a Customer Relationship Summary (“CRS”) to retail investors.³ For over six years, the IRC has assisted investors (primarily seniors) who have suffered staggering financial losses in their retirement accounts as a result of conflicted advice and, in practice, a far lower standard of conduct for broker-dealers than investment advisers.

Consistent with the SEC’s findings in its 2011 report to Congress,⁴ our clients do not understand the differences between investment advisers and broker-dealers. Most of our clients are unsophisticated investors with little meaningful prior experience, who turned to financial

¹ Launched in 2012, the IRC provides *pro bono* representation to investors of modest means who have suffered investment losses as a result of broker misconduct but, due to the size of their claims, cannot find legal representation. The IRC is the only organization in Florida available to these investors to assert their rights. To date, the IRC has recovered over \$1,000,000 on behalf of investors.

² Proposed §240.151-1, 17 CFR Part 240, Release No. 34-83062.

³ 17 CFR Part 240, 249, 275 and 279, Release No. 34-83062.

⁴ SEC, *Study on Investment Advisers and Broker-Dealers* (“SEC Study”) (Jan. 2011), available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>. The SEC reviewed two studies which it sponsored (the “Seigel & Gale Study” and the “RAND Report”), and a study conducted by Consumer Federation of America. The SEC Study found that, based on the comments, studies and surveys it had reviewed, investors did not understand the differences between investment advisers and broker-dealers. The SEC determined that this misunderstanding is compounded by the fact that many retail investors may not have the “sophistication, information, or access needed to represent themselves effectively in today’s market and to pursue their financial goals.” *Id.* at 101.

professionals (some dually registered) under the mistaken belief that those professionals would act in their best interests. Instead, many of them were sold highly complex, risky, and illiquid products that paid lucrative commissions to the brokers. When we have raised concerns on behalf of our clients with the brokerage firms involved, the typical response is that the security or investment strategy was “suitable” – despite the availability of less costly and risky alternatives.

As such, we fully support the Commission’s efforts to establish a high federal standard of conduct for broker-dealers. Consistent with the SEC’s own findings in 2011, we believe a uniform fiduciary duty among financial intermediaries who provide investment advice would eliminate confusion and best protect retail investors.⁵ In its current release, the Commission in fact observed that a uniform duty would likely provide uniformity between existing broker-dealer and investment adviser standards and could reduce the costs of advice.⁶ However, the Commission raised concerns that a uniform duty could, among other things, eliminate investor choice for financial advice, impact the cost of advice, and eliminate the differences between two important and distinct models.⁷

In the absence of a uniform fiduciary duty, we support the Commission’s efforts to raise the standard of conduct for broker-dealers through a framework that imposes duties drawn from fiduciary principles.⁸ The Commission’s proposed Reg BI would require a broker-dealer or associated person who recommends any securities transaction or investment strategy to a retail investor to “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 associated person] making the recommendation ahead of the interest of the retail customer.”⁹ The Commission purposely

⁵ The SEC recognized that “it is important that retail investors be protected uniformly when receiving personalized investment advice or recommendations about securities regardless of whether they choose to work with an investment adviser or a broker-dealer.” SEC Study, *supra* note 1, at 101.

⁶ Release 34-83062, at 330.

⁷ *Id.* Respectfully, we submit that a uniform duty for the provision of investment advice, which is focused on the recommendation instead of the compensation structure, could accommodate these concerns and differing business structures. C. Lazaro & B. Edwards, *The Fragmented Regulation of Investment Advice: A Call for Harmonization*, 4 Mich. Bus. & Entrepreneurial L. Rev. 47, 85-86 (Fall 2014).

⁸ The proposed regulation “draws upon the duties of loyalty and care as interpreted under Section 206(1) and (2) of Advisers Act.” *Id.* at 64. The Release further makes clear that under Reg BI “a broker-dealer’s duty to exercise reasonable diligence, care, skill and prudence is designed to be similar to the standard of conduct that has been imposed on broker-dealers found to be acting in a fiduciary capacity.” *Id.*, n. 222. As Chairman Clayton recently explained, the proposed best interest standard would raise the broker-dealer standard of conduct to harmonize “fiduciary principles across the spectrum of financial advice.” Speech, Chairman Jay Clayton, *The Evolving Market for Retail Investment Services and Forward-Looking Regulation — Adding Clarity and Investor Protection while Ensuring Access and Choice* (May 2, 2018), available at: <https://www.sec.gov/news/speech/speech-clayton-2018-05-02>. The proposed best interest standard would raise the broker-dealer standard of conduct to harmonize “fiduciary principles across the spectrum of financial advice.” *Id.*

⁹ Proposed §240.151-1, 17 CFR Part 240, Release No. 34-83062, at 405.

did not provide a definition of “best interest.”¹⁰ Instead, the proposed rule provides that the best interest obligation would be discharged if the broker-dealer satisfies four specific components that can be categorized into three general obligations: (1) the Disclosure Obligation; (2) the Care Obligation; and (3) the Conflict of Interest Obligations.¹¹ These obligations “establish standards of professional conduct that, among other things, would require the broker-dealer to establish reasonable care when making a recommendation.”¹²

The Commission’s approach builds upon FINRA’s suitability rule by adding important enhancements, including new disclosure obligations and the duty to place the client’s financial interests ahead of those of the firm or broker.¹³ In several critical respects, however, the current proposal does not sufficiently or comprehensively set forth the obligations broker-dealers will be required to discharge in order to meet the best interest standard. Although the release “provide[s] further guidance regarding . . . how a broker-dealer could act in the best interest of the retail customer,”¹⁴ as further discussed below, the Commission should include additional language reflecting some of the principles discussed in the Commission’s 400-page release in order to clarify the obligations of the broker-dealer.

Additionally, we urge the Commission to reconsider a resulting application of differing standards involving dually registered financial professionals. Dual registrants providing both types of services to retail clients should always be held to the higher, fiduciary standard. Finally, we suggest that the Commission make plain in its final version of the rule that it is a *minimum federal standard* governing broker-dealers and associated persons in connection with investment recommendations to retail customers. The best interest standard should not replace an otherwise higher, fiduciary standard that may apply to the account or transactions at issue due to the law in the particular jurisdiction.

¹⁰ *Id.* at 52.

¹¹ *Id.* at 8-9, 405-06.

¹² *Id.* at 59-60. The Commission explained in the Release that it did not define the term “best interest,” because whether a broker-dealer has acted in the best interest of the retail customer when making a recommendation “will turn on the facts and circumstances of the particular recommendation and the particular retail customer,” as well as the facts and circumstances of how the broker-dealer satisfies the Disclosure, Care and Conflict of Interest Obligations. *Id.* at 52.

¹³ Release No. 34-83062, at n. 7 and n.15.

¹⁴ *Id.*

I. Additional Clarity Regarding The Three Obligations Defining “Best Interest”

A. The Disclosure Obligation

The Disclosure Obligation requires the broker-dealer or associated person to “reasonably disclose to the retail customer, in writing, the material facts relating to the scope and circumstances of the relationship with the customer, including all material conflicts of interest that are associated with the recommendation.”¹⁵ At least part of this required disclosure – those relating to the scope and circumstances of the relationship – would presumably be made through a new Customer Relationship Summary (“Form CRS”), that would be provided to customers before or at the opening of a new account.¹⁶ The Form CRS would be limited to four pages and describe, among other things, the services offered by the firm, the nature of the relationship between the firm and the customer, the standard of conduct applicable to those services, the fees and costs the customer will pay for those services, and conflicts of interest.¹⁷

Although we generally support additional disclosure obligations, we have two general concerns about the obligation as stated. First, we remain concerned about the limits of disclosure and its effectiveness in protecting retail investors. Numerous studies show that cognitive biases and lack of financial literacy, among other factors, greatly diminishes the effectiveness of disclosure.¹⁸ Particularly when included among account opening documents and the firm’s customer agreement, retail investors may become overwhelmed by the information. In such cases retail investors predictably rely on their financial advisor to discuss risks, costs, and other important information, rather than read through the forms themselves, and simply sign and initial where instructed. The disclosures thereafter become a disclaimer for the broker-dealer, who use them to defend placing the investor in risky, costly, and unsuitable investments.

For example, former IRC client Anne, a 68-year old retiree, had little investment experience when she visited a financial advisor in her small town. On the heels of losing her husband, she needed advice on how to invest her modest savings (in Certificates of Deposit) so that she could better supplement her social security. The broker told her he had a “great” investment that would generate better interest than her bank CDs. Anne trusted the broker to complete the paperwork

¹⁵ *Id.* at 405.

¹⁶ 17 CFR Part 240, 249, 275 and 279, Release No. 34-83063 (April 18, 2018). Both broker-dealers and registered investment advisers would be required to provide their clients with a Form CRS. *Id.* at 7-8. For existing customers, the broker-dealer would provide the Form CRS when a new account is opened that is different from an existing account, or when changes are made to the existing account that would materially change the nature and scope of the relationship between the firm and the retail investor. *Id.* at 462.

¹⁷ *Id.* at 16-17, and Appendices C-E to the Release.

¹⁸ PIABA August 11, 2017 Comment Letter to Chairman Clayton’s Request for Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers, at 18-19 (citations omitted).

to open her account; she signed and initialed where he indicated throughout over 20 pages of forms. The broker placed her life's savings in a high-risk and costly non-traded Real Estate Investment Trust ("REIT"). He had falsified her net worth and income, and falsely stated on the forms that she had prior investment experience, including investing in REITs. The broker-dealer claimed the REIT was suitable and that Anne understood the risks because she had initialed the series of disclosures on the REIT's subscription agreement in accordance with the broker's instructions. When asked why she did not read the account application and subscription agreement, Anne told us that she did not have prior experience and would not understand the information; she also stressed that she trusted the broker because he was the son of a well-respected businessman in her small town, and others said nice things about him.

Anne's story is not unique. Meaningful disclosure should be more than handing the investor a form. Associated persons should explain the costs and benefits of the proposed transaction or strategy, ensure that his or her client understands the recommendation, its costs and, importantly, maintain records evidencing such disclosure. Any written disclosure, such as that included in the proposed form CRS, should be simple and in plain English, and not buried in volumes of pages describing the customer agreement. Broker-dealers should also be prepared to provide meaningful disclosure in languages other than English. There are 25.9 million Americans with Limited English Proficiency (LEP).¹⁹ The number of LEP individuals has grown by 81 percent since 1990,²⁰ and as the population continues to grow so does the demand for documentation in languages other than English.

We also strongly urge the Commission to make clear that the disclosure obligations also apply to each *recommendation*, not merely the relationship. As currently proposed, §240.151-1(a)(2)(i) requires the disclosure of "all material conflicts of interest that are associated with the recommendation." The Commission acknowledges that the "fees and charges are important to retail investors" yet many investors are uninformed as to what they will pay.²¹ Although the Form CRS may provide the investor with a general schedule of fees the *firm* will charge for its services, the CRS would not necessarily capture any additional costs to investors associated with the recommendation (i.e., fund loads or surrender charges). Investors should be provided with clear and concise information that fully and fairly discloses the specific charges he or she will incur as a result of the particular recommendation.

B. Expressly Include Costs as a Factor of the Care Obligation

The Care Obligation requires the broker-dealer or associated person to exercise reasonable diligence, care, skill, and prudence to: "(a) [u]nderstand the potential risks and rewards

¹⁹ Jeanne Batalova & Jie Zong, *Language Diversity and English Proficiency in The United States*, <https://www.migrationpolicy.org/article/language-diversity-and-english-proficiency-united-states> (Nov. 11, 2016).

²⁰ Monica Whatley, Jeanne Batalova, *Limited English Proficient Population of the United States*, <https://www.migrationpolicy.org/article/limited-english-proficient-population-united-states-0> (July 25, 2013).

²¹ *Id.* at 107.

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) [h]ave 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) [h]ave 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."²²

The Care Obligation is an enhancement of FINRA's suitability rule. Proposed Reg BI has substituted references to "suitability" with "best interest," thereby elevating the standard of conduct for broker-dealers in connection with recommendations to retail investors. The Release further explains that a broker-dealer cannot cure a violation of the Care Obligation with disclosure.

The costs associated with a particular recommendation is a central requirement under the Care Obligation and, therefore, an enhancement of the broker-dealer's existing obligations.²³ The Commission explained that to the extent a broker-dealer recommends a "more expensive" security or investment strategy, the broker-dealer must have a reasonable basis that the recommendation is justified given the characteristics or features of the security or strategy and the customer's profile and investment objectives.²⁴ However, this factor is not expressly stated in the text of the rule defining the Care Obligation, or anywhere else. The only factors that are expressly enumerated are those set forth in the definition of "Retail Customer Investment Profile," which does not include a consideration of costs of the recommended transaction.²⁵ We strongly urge the Commission to include in the care obligations an express reference to the cost of the recommended transaction or strategy (and disclosure of those actual costs to the investor). To the extent there are less expensive alternatives available, the disclosure should include an explanation to the investor as to why the recommended security transaction or investment strategy is nevertheless in the investor's best interest given other factors associated with the recommendation.²⁶

²² *Id.* at 405-06.

²³ *Id.* at 135, 143.

²⁴ *Id.* at 56-57.

²⁵ The second prong of the Care Obligation requires that the recommendation be in the best interest of the investor based upon the "retail customer's investment profile," which is a defined term. Specifically, §240.151-1(b)(2) provides that "Retail Customer Investment Profile" includes, but is not limited to, the retail customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the retail customer may disclose to the [broker-dealer or associated person]." *Id.* at 407.

²⁶ *Id.* at 56.

C. *Avoiding or Mitigating Financial Conflicts Should be a Critical Component of “Best Interest”*

The Conflict of Interest Obligations would require broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to: “(a) identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendations; and (b) identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.”²⁷

In its release, the Commission recognized the substantial harm to retail investors caused by financial conflicts of interest.

The IRC’s experience is consistent with studies that show the substantial costs of conflicted advice to retail investors. Our typical clients are retired individuals who entrusted their life savings to a broker who, in turn, invested their savings in securities that paid huge fees and commissions to the broker and the issuer. The IRC has pursued dozens of such claims, which have the recurrent theme that the broker has a fundamental conflict of interest in making a recommendation. Specifically, in nearly every case the IRC has handled, the broker has made an investment recommendation that was in the broker’s financial best interest, and not in the customer’s best interest. In many of those cases, the products were not only more expensive to own (directly impacting any potential returns), but the securities underperformed less expensive alternatives and posed substantially greater risks. The characteristics of these products gave brokers incentives to sell them, rather than reasons for their clients to buy them. We have found that our clients did not understand, and were never told by their brokers, that the brokers had no duty to put the customer’s financial interests ahead of those of the broker.

Given the significant limitations of disclosure and costs of conflicted advice to retail investors, we urge the Commission to clarify that broker-dealers and associated persons cannot simply *disclose* financial conflicts of interest, but rather, must *avoid* or *mitigate* financial conflicts. Those conflicts should include practices that incentivize associated persons to push certain products or strategies, including firm sales quotas, firm-sponsored sales contests, and third-party incentives such as expensive gifts, travel, and other remunerations.

II. Dually Registered Financial Professionals Should Be Held to Fiduciary Standard

Proposed Reg BI would allow a dually registered investment adviser to observe two different standards when dealing with clients. Specifically, Reg BI would apply to an investment adviser that is making a recommendation in his or her capacity as a broker; however, it would not apply when the same financial professional is making the recommendation in his or her “investment adviser capacity,” in which case a fiduciary duty would apply.²⁸ Respectfully, this approach to dually registered individuals would add to the existing confusion among retail investors about the duties of their financial professionals.

²⁷ Release No. 34-83062, at 406.

²⁸ *Id.* at 41.

For example, former IRC client Sylvia, a 69-year-old retiree, met with an RIA and a self-described “senior specialist” who had made a presentation at her senior community center. He provided her investment advice, but then proceeded to place nearly 70 percent of her portfolio in non-traded REITs and risky closed-end funds sold through the brokerage firm with which he was associated. The broker-dealer claimed that neither the firm nor the broker owed Sylvia a fiduciary duty, and further argued that these highly risky investments were “suitable.” In other words, although the dually registered broker held himself out as an investment adviser and clearly owed her a fiduciary duty when providing investment advice, his duty changed when he “switched hats” and became a salesman of these high cost and risky investments.

This is not a solitary case. The Clinic has handled many cases involving dually registered individuals and the theme is the same: The retail investor did not understand the significance that his or her investment adviser’s duty would change depending on the particular service rendered. Given the increase of brokers operating under an independent RIA model, the Commission should reconsider its position and issue a final regulation that requires dually registered individuals who advertise as investment advisers to adhere to a fiduciary duty when rendering financial advice and making investment recommendations to their clients.

III. Regulation BI Should Not Displace State Law Requiring a Higher Standard

The proposed regulation elevates the current suitability standard applicable to broker-dealers when making investment recommendations to their clients, adding important enhancements to that obligation. However, Reg BI should set a *minimum* standard of conduct for broker-dealer recommendations, and not preempt or replace existing state law that would otherwise impose a *higher* fiduciary duty. The state of Nevada, for example, passed a law in 2017 that imposes a fiduciary duty on broker-dealers, sales representatives, and investment advisers who give investment advice.²⁹ A number of other states have passed or are considering similar legislation,³⁰ and many state courts have imposed fiduciary or quasi-fiduciary duties on broker-dealers and other financial professionals who provide investment advice.³¹ The proposed regulation should not abrogate any additional protections provided to residents in states where

²⁹ Nevada SB 383, 79th Sess. (September 8, 2017).

³⁰ Kristen Ricaurte Knebel, *States Look to Help Investors, With Fiduciary Rule in Flux*, Bloomberg News (Feb. 27, 2018), available at: <https://www.bna.com/states-look-help-n57982088470/>.

³¹ See, e.g., *Hobbs v. Bateman Eichler, Hill Richards, Inc.*, 164 Cal.App.3d 174 (Cal. Ct. App. 1985) (“The relationship between a broker and principal is fiduciary in nature and imposes on the broker the duty of acting in the highest good faith toward the principal.”)(*citations omitted*); *Csordas v. Smith Barney, Harris Upham & Co, Inc.*, 1992 WL 426460, No. CI91-1764 (Fla. Cir. Ct., July 16, 1992) (“The law is clear that a securities broker owes to his investment customer a fiduciary duty of loyalty and due care when recommending the purchase of a security.”)(*citations omitted*). See also, Michael Finke & Thomas P. Langdon, *The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice*, Journal of Financial Planning (Mar. 9, 2012), available at: <https://www.onefpa.org/journal/Pages/The%20Impact%20of%20the%20Broker-Dealer%20Fiduciary%20Standard%20on%20Financial%20Advice.aspx>.

the legislature or courts have provided by law enhanced obligations on broker-dealers and others providing investment advice.

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We thank you again for the opportunity to comment on this proposal.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Teresa J. Verges', with a long horizontal line extending to the right.

Teresa J. Verges
Director, Investor Rights Clinic