

**Faculty Supervisors**

JONATHAN BROWN  
DAVID N. DORFMAN  
MARGARET M. FLINT  
ROBIN FRANKEL  
ELISSA GERMAINE  
THOMAS MCDONNELL  
VANESSA MERTON  
JASON PARKIN

**JOHN JAY LEGAL SERVICES, INC.**

ELISABETH HAUB SCHOOL OF LAW  
80 NORTH BROADWAY  
WHITE PLAINS, NY 10603  
TEL 914-422-4333  
FAX 914-422-4391  
JJLS@LAW.PACE.EDU

**Executive Director**

MARGARET M. FLINT

**Clinic Administrator**

ROBERT WALKER

**Staff**

MIGUEL SANCHEZ ROBLES  
BRENDA THORNTON

August 7, 2018

**VIA ELECTRONIC SUBMISSION**

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

**Re: File Number S7-07-18, Regulation Best Interest**

Dear Mr. Fields:

The Investor Rights Clinic at the Elisabeth Haub School of Law at Pace University, operating through John Jay Legal Services, Inc. (PIRC),<sup>1</sup> welcomes the opportunity to submit this letter in response to the SEC's request for comment on its proposal to establish a standard of conduct for broker-dealers and their associated persons when recommending any transaction or investment strategy involving securities to a retail customer. Specifically, the SEC proposes requiring that broker-dealers act in the "best interest of the retail customer at the time the recommendation is made." While PIRC supports the SEC's efforts to establish a heightened standard of conduct for broker-dealers, it urges the SEC to establish an even more stringent and protective standard. PIRC respectfully recommends that the SEC establish a uniform fiduciary duty standard of conduct for broker-dealers and registered investment advisers. This proposed standard would provide all investors with the level of protection that they rightly deserve.

**I. The Proposed Regulation Best Interest Will Create Investor Confusion**

While the proposed Regulation Best Interest is a welcome attempt at enhancing the protections investors need from their broker-dealers, PIRC finds that these protections fall short of what investors, especially unsophisticated investors of modest means, need. The proposal does not define the term "best interest," and the proposed language still allows broker-dealers to make recommendations to customers partly based on the broker-dealer's financial or other vested

---

<sup>1</sup> PIRC opened in 1997 as the nation's first law school clinic in which law students, for academic credit and under close faculty supervision, provide pro bono representation to individual investors of modest means in arbitrable securities disputes. See Barbara Black, *Establishing A Securities Arbitration Clinic: The Experience at Pace*, 50 J. LEGAL EDUC. 35 (2000); see also Press Release, Securities Exchange Commission, SEC Announces Pilot Securities Arbitration Clinic To Help Small Investors - Levitt Responds To Concerns Voiced At Town Meetings (Nov. 12, 1997), available at <http://www.sec.gov/news/press/pressarchive/1997/97-101.txt>.

interests. Further, the three component obligations to the best interest standard do not grant customers the protections they need and many think they already enjoy. The Disclosure Obligation permits brokers to recommend transactions partly based on their own vested interests. The Care Obligation is remarkably similar to the current suitability standard to which brokers must comply, without providing substantial additional protection. The Conflict of Interest Obligations merely require that brokers have protocols in place to “identify and at a minimum disclose” material conflicts of interest to customers. The proposed standard does not require brokers to eliminate material conflicts of interest as many customers expect their brokers to do.

## **II. The Line Between Broker-Dealers and Investment Advisers is Already Disappearing**

The SEC’s Investor Advisory Committee recommended that the SEC “impose a fiduciary duty on broker-dealers when they provide personalized investment advice to retail investors.”<sup>2</sup> PIRC agrees with the Committee’s reasoning as to why a fiduciary duty standard is needed for broker-dealers. The Committee recommended imposing this fiduciary duty on brokers because it recognized that “the roles of some broker-dealers and investment advisers have converged . . . many broker-dealers today offer advisory services . . . that are similar to the services offered by investment advisers.”<sup>3</sup> Moreover, “many broker-dealers use titles such as financial adviser for their registered representatives and market themselves in ways that highlight the advisory aspect of their services.”<sup>4</sup> The Committee concluded that the similarities between the services offered by broker-dealers and investment advisers can result in customers being harmed if “they choose a financial advisor under a mistaken belief that the financial advisor is required to act in their best interest when that is not the case.”<sup>5</sup>

Indeed, investors today seem to place an equal amount of trust in both their brokers and investment advisers. The Public Investors Arbitration Bar Association (PIABA) study of the advertising of nine major brokerage firms found that all of these firms “advertise in a fashion that is designed to lull investors into the belief that they are being offered the services of a fiduciary.”<sup>6</sup> Brokers often market themselves to clients as offering “unconflicted, trustworthy advice.”<sup>7</sup> The trust that investors place in their brokers can be properly safeguarded only by requiring both brokers and investment advisers to act as fiduciaries to their customers. This uniform standard of conduct will eliminate the confusion many investors have when they learn, most often after the fact when a dispute arises, that brokers and investment advisers are currently held to different standards of care. Additionally, in our experience, even if investors were aware of a distinction between the duties of brokers and investment advisers, that distinction would be lost when they meet with their brokers at the offices of an investment advisory firm in the case of

---

<sup>2</sup> Recommendation of the Investor Advisory Committee: Broker-Dealer Fiduciary Duty, <https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation-2013.pdf>.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> Joseph C. Peiffer & Christine Lazaro, *Major Investor Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of a Fiduciary Duty*, PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION (Mar. 25, 2015), <https://piaba.org/sites/default/files/newsroom/2015-03/PIABA%20Conflicted%20Advice%20Report.pdf>, at 1.

<sup>7</sup> *Id.* at 8.

dually registered financial professionals, or because the broker's job title included a term such as investment adviser, financial adviser, financial professional, investment professional, financial consultant, investment consultant, financial manager, or investment manager. A uniform fiduciary rule will eliminate the confusion that can arise in situations such as these. This uniform standard will also bring stability to the financial services industry – especially in the face of individual states' efforts to enact their own “best interest” standards of care for brokers. Additionally, while the proposed Form CRS Relationship Summary and Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles is a positive step, we do not believe it fully will resolve investor confusion regarding the differences between the services offered by investment advisers and brokers. Our experience is that investors often have a personal relationship with their brokers, which results in investors placing great trust in their brokers. A form explaining to investors the differences in the standards to which investment advisers and brokers are held will most likely mean little to investors who reasonably believe that their brokers will act in their best interest due to their already established personal relationship.

### **III. The Proposed Regulation Best Interest Will Not Markedly Increase Investor Protection**

As the proposed rule currently is drafted, regulation “best interest” is somewhat of a misnomer. The proposed “best interest” obligation provides:

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.<sup>8</sup>

A close reading of this language makes evident that the proposed rule does not require that broker-dealers eliminate any financial or other interests the broker has when making a recommendation to a customer. This rule would allow brokers to make recommendations to customers that were partly motivated by the broker's own financial or other interests. This is contrary to what customers have in mind when they think that their broker-dealers must act in their “best interest,” and contrary to how brokers oftentimes present themselves to customers.

The regulation goes on to list three obligations that shall satisfy broker-dealers' new Best Interest Obligation: (1) the Disclosure Obligation, (2) the Care Obligation, and (3) the Conflict of Interest Obligations. First, broker-dealers would be able to satisfy the Disclosure Obligation if they reasonably disclose to the 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.”<sup>9</sup> This would mean that as long as broker-dealers

---

<sup>8</sup> Proposed section 240.15l-1(a)(1) (emphasis added).

<sup>9</sup> Proposed section 240.15l-1(a)(2)(i).

disclose “all material conflicts of interest” that color their recommendations to their customers and these material interests are not put above the customer’s “best interest,” broker-dealers may still act in their own best interest.

While requiring that broker-dealers disclose the interests they have in a specific recommendation theoretically could be helpful to customers, it is PIRC’s experience that, in practice, this requirement will not make significant strides in enhancing investor protection. Even if their brokers had actually disclosed this information to them, many of PIRC’s clients would not have taken these disclosures into account when deciding whether to accept or reject their brokers’ recommendation. Customers have a relationship based on trust with their brokers. Oftentimes this trust is what motivates customers to decide to invest in a particular investment product that is praised and recommended by their brokers. Customers trust their brokers’ judgment and do not want to second-guess their professional experience. In many cases, customers are unable to independently determine whether or not the investment is in their best interest. Customers place a higher value on the trusting nature of their relationship with their brokers than in any disclosures their brokers would have to provide under this proposed rule. In many situations, no amount of disclosures would be enough to counteract this deep level of trust customers place in their brokers. This is especially true for customers with little to no financial education or sophistication. This proposed standard by the SEC is inadequate because of the likelihood that requiring additional disclosures to customers will not increase investor protection.

Second, under the Care Obligation, when making recommendations, broker-dealers must exercise “reasonable diligence, care, skill and prudence” to:

(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 . . . is not excessive and is in the retail customer’s best interest when taken together in light of the retail customer’s investment profile.<sup>10</sup>

This Care Obligation is very similar to the current suitability standard for broker-dealers. FINRA Rule 2111(a) provides that a “member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer’s investment profile.” The only major difference is that the word “suitable” has now been replaced with the undefined term “best

---

<sup>10</sup> Proposed section 240.15l-1(a)(2)(ii)(A)-(C).

interest.” In essence, this new “best interest” standard has not been written in a way that significantly will advance investor protection from its current state. Commissioner Hester M. Peirce characterized this proposed standard as more like a “suitability-plus standard.”<sup>11</sup> This is because in addition to requiring a suitability-like standard of conduct from broker-dealers, the proposed standard will also require certain disclosures and protocols that deal with conflicts of interest. But because requiring disclosures (as discussed above) and creating protocols dealing with conflicts of interest (as discussed below) will most likely not lead to increased investor protection, we agree with Commissioner Kara M. Stein’s contention that this proposal “essentially maintain[s] the status quo.”<sup>12</sup>

Third, broker-dealers can satisfy their Conflict of Interest Obligations by establishing, maintaining, and enforcing:

(A) . . . 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) . . . 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.<sup>13</sup>

The language in the proposed regulation makes it clear that broker-dealers may satisfy nearly all of their conflict of interest obligations to customers by simply identifying and disclosing material conflicts of interest to the customer (except in the case of material conflicts of interest stemming from the financial incentives accompanying a recommendation where brokers would have a duty identify, disclose, and mitigate such conflicts). Indeed, the SEC even acknowledged that the regulation would not prohibit broker-dealers from having conflicts when making a recommendation.<sup>14</sup>

Thus, because broker-dealers still can have material conflicts of interest when making a recommendation to a customer, PIRC agrees with Commissioner Stein’s contention that the proposed rule will end up confusing both investors and broker-dealers alike since the name of the standard – best interest – is misleading.<sup>15</sup> As Commissioner Stein pointed out, the term “best interest” is never actually defined in the proposal.<sup>16</sup> Customers will think that their broker-dealers have to act in their best interests. The rule’s very name gives them that impression. But a

---

<sup>11</sup> See Commissioner Hester M. Peirce’s Statement at the Open Meeting on Standards of Conduct for Investment Professionals, <https://www.sec.gov/news/public-statement/statement-peirce-041818>.

<sup>12</sup> See Commissioner Kara M. Stein’s Statement on Proposals Relating to Regulation Best Interest, Form CRS, Restrictions on the Use of Certain Names or Titles, and Commission Interpretation Regarding the Standard of Conduct for Investment Advisers, <https://www.sec.gov/news/public-statement/stein-statement-open-meeting-041818>.

<sup>13</sup> Proposed § 240.15l-1(a)(2)(iii)(A)-(B) (emphasis added).

<sup>14</sup> See 17 CFR 240 Release No. 34-83062 on page 48 (“We do not intend for our standard to prohibit a broker-dealer from having conflicts when making a recommendation.”).

<sup>15</sup> See Stein, *supra* note 12.

<sup>16</sup> *Id.*

closer look at the actual language of the rule quickly does away with that impression. PIRC joins Commissioner Stein in her suggestion that the Commission define what “best interest” means.<sup>17</sup>

#### **IV. A Uniform Fiduciary Standard Will Provide Investors with the Level of Protection They Deserve**

While it is commendable that the SEC’s proposed standard will apply to all retail customer accounts (as opposed to the Department of Labor’s now vacated Fiduciary Rule), the SEC should go further in establishing protections for retail customers. PIRC recommends that the SEC create a uniform fiduciary duty standard of conduct for both broker-dealers and investment advisers as proposed in the *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* written by the Staff of the U.S. Securities and Exchange Commission (Jan. 2011) (“913 Study”). The 913 Study’s goal was to evaluate the “effectiveness of [the then] existing legal or regulatory standards of care . . . for providing personalized investment advice and recommendations about securities to retail customers” and whether there were any “legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.”<sup>18</sup> The 913 Study proposed applying the current fiduciary standard for investment advisers onto broker-dealers. This would require registered firms “to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer or investment adviser providing the advice.”<sup>19</sup> This fiduciary standard would also require both investment advisers and brokers alike to “fully disclose to [their] clients all material information that is intended to ‘eliminate, or at least expose, all conflicts of interest which might incline an investment adviser – consciously or unconsciously – to render advice which was not disinterested.’”<sup>20</sup> The highlighted portion of the text implies that, at the very least, investment advisers and broker-dealers would be required to expose all conflicts of interest to clients. This is where our recommendation differs from the current fiduciary standard that is applied to investment advisers. PIRC urges the SEC to enact a fiduciary standard that requires investment advisers and broker-dealers to eliminate all material conflicts of interest. While PIRC recognizes that the Commission values preserving a diverse range of services and products offered to customers and that a requirement that investment advisers and broker-dealers eliminate all material conflicts of interest may curtail some amount of services or products available, PIRC believes this approach would provide customers with the highest level of protection. Should the Commission find this elimination requirement too burdensome, PIRC urges the Commission to model its new standard for broker-dealers after the current fiduciary standard of conduct for investment advisers and require full and fair disclosure of any conflicts that are not eliminated or mitigated.

---

<sup>17</sup> See Stein, *supra* note 12 at Request for Comment Number 4 under “Best Interest,” (seeking comment on whether the Commission should adopt the following definition of best interest: “To act in the best interest’ means when a broker, dealer, or natural person who is an associated person of a broker or dealer, makes a recommendation, the recommendation reflects the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use taking into consideration all of the facts and circumstances, including the investment profile of the Retail Customer to whom the recommendation is made?”).

<sup>18</sup> 913 Study, at i, <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

<sup>19</sup> *Id.* at vi.

<sup>20</sup> *Id.* at 22 (emphasis added).

A uniform fiduciary standard would provide investors with a level of protection that is more in line with how they actually reasonably expect their brokers to behave. Customers expect that their broker-dealers and investment advisers will provide advice and recommendations based on the customer's best interest and not the broker's own. Because brokers and investment advisers are entrusted with customers' hard-earned money, nothing less than the highest level of protection should be provided to investors by the SEC. Having one uniform standard of conduct will also eliminate the difference between the standard of conduct for investment advisers and the standard of conduct for brokers. Most of the investors who have reached out to PIRC for help were unaware that there were different standards for broker-dealers and investment advisers and fail to understand why they are held to different standards. It is doubtful that a disclosure form explaining the difference between the two standards will help clear up this common customer oversight. This difference in standards has often been the source of consternation and confusion among our clients after a dispute with their broker arises. They cannot seem to square away the fact that their broker-dealers are not currently required to have their best interests at heart and are merely held to an abstract-sounding "suitability" standard. Implementing a uniform standard of conduct will ensure that customers no longer have to struggle to understand the difference between the two.

Adoption of a uniform fiduciary standard of conduct should not be too disruptive to the financial services industry. Many retail brokerage institutions were able to adapt to the Department of Labor's Fiduciary Rule and similarly could adapt to a uniform fiduciary duty standard of conduct. While the Department of Labor's Fiduciary Rule only applied to retirement accounts, it should not be too difficult to adapt to a uniform standard across all retail brokerage accounts. While the Department of Labor's Fiduciary Rule was vacated by the Fifth Circuit Court of Appeals, some individual states have stepped forward to require their own "best interest" standard – creating further confusion in the industry and also among customers.<sup>21</sup> This recent trend to increase investor protection by states could be partly motivated by the fear of firms rolling back their enhanced customer protections in the wake of the Fifth Circuit's decision to vacate the Department of Labor's Fiduciary Rule.<sup>22</sup> But since some firms have already made big strides in strengthening the protections they currently offer to their customers, the SEC should be able to adopt a fiduciary standard of conduct for broker-dealers without much disruption to the financial services market.<sup>23</sup>

---

<sup>21</sup> See Mark Miller, *U.S. states eye protections for investors if federal regulation falters*, REUTERS (Apr. 12, 2018), <https://www.reuters.com/article/us-column-miller-fiduciary/u-s-states-eye-protections-for-investors-if-federal-regulation-falters-idUSKBN1HJ1NT>; see also Mark Schoeff Jr., *State-level activity slows on fiduciary legislation*, INVESTMENT NEWS (July 12, 2018), <http://www.investmentnews.com/article/20180712/FREE/180719966/state-level-activity-slows-on-fiduciary-legislation>.

<sup>22</sup> See Jed Horowitz, *JPMorgan to Remove Some Fiduciary Rule Handcuffs, Other May Follow*, ADVISORHUB (May 4, 2018), <https://advisorhub.com/jpmorgan-to-remove-some-fiduciary-rule-handcuffs-others-may-follow/>.

<sup>23</sup> See generally David Trainer, *Even Without The Rule, Fiduciary Awareness Remains*, FORBES (Mar. 16, 2018), <https://www.forbes.com/sites/greatspeculations/2018/03/16/even-without-the-law-fiduciary-rule-awareness-remains/#1ebc040f425a>; Bruce Kelly, *Bank of America's Moynihan: No quick pullback from fiduciary rule*, INVESTMENT NEWS (July 18, 2017), <http://www.investmentnews.com/article/20170718/FREE/170719936/bank-of-americas-moynihan-no-quick-pullback-from-fiduciary-rule>; *Merrill Lynch keeps approach despite U.S. fiduciary rule changes: memo*, REUTERS (Mar. 16, 2018), <https://www.reuters.com/article/us-usa-wealth-fiduciaryrule-bofaml/merrill-lynch-keeps-approach-despite-u-s-fiduciary-rule-changes-memo-idUSKCN1GS2S1>.

## **V. Conclusion**

While Regulation Best Interest does enhance existing protections for customers, it does not go far enough. The “best interest” obligation itself is undefined and will create confusion among investors and broker-dealers. The addition of disclosure and conflict of interest obligations to a care obligation that is essentially a suitability-like standard does not sufficiently enhance investor protection. Both investors and the financial services industry would benefit from a stable, uniform standard of conduct for both broker-dealers and investment advisers. It would eliminate any existing confusion among customers as to what standard broker-dealers and investment advisers have to uphold. It would also eliminate uncertainty within the financial services industry about possible future changes to the standard for broker-dealers. Establishing a uniform fiduciary standard for both broker-dealers and investment advisers is the best way to protect investors from financial harm and would finally provide investors with the level of protection that they not only might think they already have, but also deserve.

Respectfully submitted,

Pace Investor Rights Clinic

Matla Garcia Chavolla  
Student Intern, PIRC

Elissa Germaine  
Director, PIRC