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Securities and Exchange Commission
100 F St. NW
Washington, DC 20549-9303
Rule-comments@sec.gov

Re: Regulation Best Interest, Form CRS, Enhancing Investment Adviser Regulation

File SR-07-07-18, IA-4888, IA-4889

Dear SEC:

Here are my comments on the proposed “Best Interest” standard and associated issues.

Summary:

- Don’t limit the rule to “securities” transactions, but extend the rule to all “sales practices” of a BD or RIA in accordance with the statutory text.
- Put “simple and clear” back into the required disclosures as directed by Congress. Consider model forms such as used in Truth-in-Lending Act and privacy disclosures.
- Use §912 authority to test model disclosures.

¹ All opinions are strictly my own and do not necessarily represent those of Georgetown University or anyone else.

- The costly record keeping requirements are redundant and unnecessary as firm self-interest will lead them to keep proof of compliance.
- The “some retail customer” text in (a)(2)(ii)(A) is redundant to (a)(2)(ii)(B).
- SEC’s failure to consider how other jurisdictions address these conflicts creates legal jeopardy for the rulemaking.
- The high level of redundancy in the proposing release hurts, not helps, the Commission’s case.

Background

The Commission is proposing a rule that broker-dealers must act in the best interest of retail clients and disclose (or better yet, eliminate) conflicts of interest. Right on!

Good financial advice, like good medical or legal advice, can be worth its weight in gold. Financial decisions can be quite tricky, and most investors can benefit from good professional advice. Even though the average financial advisor cannot by definition deliver better than average performance, or positive “alpha,” good advisors can still provide extremely valuable advice.² Financial advisors can help investors determine the right amount of saving and investing, achieve an appropriate asset allocation, and avoid tax pitfalls. Advisors can also help clients avoid emotional pitfalls. Indeed, an advisor who does nothing more than keep a client from selling everything at fire-sale prices at the bottom of a panic may more than earn a lifetime of fees. Even though I have a PhD in finance and I am a CFA charter holder, I regularly seek out financial advice regarding various financial products, tax issues, and other financial matters.

There are five basic ways of paying for financial advice. All of them have conflicts of interest:

Asset-based fees. Some advisors charge a percentage of the assets under management. This creates an obvious incentive to maximize the amount of assets under management, whether or not it is in the best interest of the client. This actually happened to my terminally-ill brother-in-law. He received an investment pitch in which the advisor recommended that he borrow against his house to invest in a risky investment scheme.

Hourly fees. An advisor who charges by the hour has an incentive to bill for more time than is necessary to complete the task. “Let’s have a nice long conversation about your cat’s birthday.”

Fixed fees. At the other extreme, an advisor who charges a fixed fee for a plan has an incentive to shirk and deliver a cookie-cutter plan that is the same for all customers.

² I use the more common spelling “advisor” to refer to generic purveyors of advice, and the spelling “adviser” when referring to Registered Investment Advisers (RIAs) as used in the Investment Advisers Act of 1940. Google shows 5.3 million hits for “financial adviser” versus 27.7 million hits for “financial advisor.”

Commissions. An advisor who is paid by commission has an incentive to push the products that pay the highest commission, whether or not they are in the best interest of the customer.

Reciprocity. Advice is often given informally to friends and relatives with the expectation of some form of reciprocity. One's brother-in-law may give some investment advice but also expects you to be on-call to help with his plumbing issues.

These conflicts are not unique to financial services. Compensation schemes in law, medicine, and auto repairs suffer from similar conflicts of interest. Our society deals with these conflicts with a variety of customs, laws, regulations, and professional standards.

What is unique about financial services is the extreme nature of the information asymmetries. Consumers may not be able to determine the quality of the financial advice for many decades. Furthermore, there are additional information asymmetries stemming from the issuers of the financial products. For these reasons and others, financial services are highly regulated around the world.

Traditionally, Registered Investment Advisers (RIAs), who are regulated under the Investment Advisers Act of 1940, sold advice, and the execution of that advice was incidental. RIAs have been held to a "fiduciary standard" that generally requires that they act in the best interest of their clients. They are also generally prohibited by statute from trading directly with their customers. Large RIAs are regulated directly by the SEC, but smaller RIAs are generally regulated by the states.³

Brokers, on the other hand, traditionally sold products and were paid by commission. Any advice they offered was "solely incidental" to the selling of products. Brokers have been held to a "suitability" standard that is weaker than a "best interest" standard.⁴ Brokers can and do internalize orders and trade directly with their own customers. Indeed, the willingness of brokers to hold inventory helps them to satisfy their customers' needs for liquidity. Brokers can buy when customers want to sell, and they can sell when customers want to buy. Brokers are generally regulated by FINRA.

Proprietary trades with institutional investors, on the other hand, are not held to even a suitability standard, nor should they be. When large and sophisticated institutions trade with each other, the assumption is that both institutions know or should know what they are doing and are not relying upon the advice of their counterparty. When Goldman Sachs is trading with JP Morgan, the standard is *caveat emptor*.⁵

Purveyors of insurance-linked products are not regulated at the federal level, but are regulated by various states. While each state generally has some sort of suitability requirement for insurance products, the

³ Investment advisers with less than \$100 million under management are generally regulated at the state level. New York and Wyoming do not register investment advisers.

⁴ See Angel, James J., and Douglas McCabe. "Ethical standards for stockbrokers: fiduciary or suitability?." *Journal of Business Ethics* 115.1 (2013): 183-193.

⁵ The standard anti-fraud provisions such as 10(b) still apply, of course.

precise requirements and their enforcement, if any, vary from state to state.⁶ Indeed, many of the worst sales abuses are in the area of complex insurance products that are marketed as investment vehicles.

Advisors use a bewildering array of titles that can confuse consumers. It is next to impossible for the average person to figure out what regulatory bucket or standard of care applies to a particular title. Alas, there are some bad apples in the industry who engage in unsavory practices. These range from shoving unsuitable products down the throats of unsophisticated investors to charging excessive fees for otherwise suitable investments.

Consumer groups have long criticized this gap in consumer protection and have called for a uniform “fiduciary” standard. Indeed, this was one of the campaign pledges of Barack Obama when he was running for president. The Dodd-Frank Act of 2010 gave the SEC the authority to impose uniform standards on the retail sales practices of broker dealers and RIAs. Insurance agents were left out, a testament to the great lobbying power of the insurance industry.

The SEC failed to exercise this regulatory authority to protect investors and instead misallocated its scarce regulatory resources in other areas. No wonder the agency has trouble getting needed resources from Congress. It’s hard to justify needed funding from Congress when there is a history of resource misallocation, let alone blatantly ignoring Congressional direction.

Faced with regulatory inaction at the SEC, the Obama administration turned to the Department of Labor (DOL). The DOL has some very limited authority over retirement accounts, and it attempted to extend this authority to promulgate a complicated “best interest contract” rule for retirement accounts. Alas, non-retirement accounts were totally left out.

The DOL has very little experience in the area of investor protection, and it showed in the rule. Furthermore, the DOL does not have and is not likely to get resources to enforce the rule, so it left enforcement up to the plaintiff bar. The result is that it would have taken years of expensive and uncertain litigation to determine what the DOL rules really meant. Fortunately, the DOL rules seem to be dead for now. *Requiescat in Pace*. Having clear, uniform rules that apply to all purveyors of financial products, whether retirement or not, is what we need. These proposals are a step in the right direction and they can be made better.

The SEC has finally proposed something that makes sense, and something it could have and should have proposed years ago. It has proposed that broker recommendations to retail customers must be in the best interest of the customer given the information that the broker has about the customer’s situation. It is also proposing lots of redundant paperwork to create, document, and enforce policies and procedures, and to store every bit of information provided by or to customers for six years. The SEC is also proposing the

⁶ The National Association of Insurance Commissioners has a model regulation calling for annuity products to be suitable. <http://www.naic.org/store/free/MDL-275.pdf>. New York State is proposing to raise its insurance standard to a best interest standard. See https://www.dfs.ny.gov/insurance/r_prop/rp187a1text.pdf.

well-intentioned creation of a Customer Relationship Summary that in its present incarnation will be just another piece of unread regulatory paperwork headed straight for the landfill.

Don't limit the rule to securities transactions, but extend it to any sales advice given by a BD or RIA.

One of the impacts of Regulation Best Interest will be that retail investors will come to expect that the advice given by brokers and RIAs will be in the investor's best interest. This is good. However, there is a loophole in that the proposed regulation only applies to "recommendation of any securities transaction or investment strategy involving securities to a retail customer."

The rule would appear **not** to apply to insurance or any other products sold by the same broker-dealers. Indeed, some of the worst abuses in retail financial planning involve complicated "insurance" products that are improperly foisted upon trusting consumers.

In addition to the rulemaking authority for a uniform standard of conduct, Dodd Frank §913 gives the SEC clear statutory authority to do more (**emphasis added**):

“(1) OTHER MATTERS.—The Commission shall—
“(1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest; and
“(2) examine and, where appropriate, **promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers** that the Commission deems contrary to the public interest and the protection of investors.”.

This paragraph (l), OTHER MATTERS, is a separate paragraph to the previous paragraph (k), STANDARD OF CONDUCT, which provided authority for a uniform retail standard of conduct between RIAs and BDs. It is NOT a limitation or a qualification of paragraph (k). Note that paragraph (l) gives the Commission rulemaking authority over the *sales practices* of broker-dealers and RIAs. Congress did NOT limit this authority to the sales practices regarding *securities*. It also did not limit this to retail investors.

Let me repeat this important point for emphasis: this authority on sales practices and compensation schemes is not limited to retail sales practices for securities. **The SEC has clear statutory authority to regulate *all* sales practices regarding anything sold by those licensed as broker-dealers and RIAs, including insurance products and negative amortization subprime mortgages.**

The SEC should find that a broker's or RIA's recommendation of any financial product not in the best interest of the investor is a sales practice that is contrary to the public interest and the protection of

investors. The SEC should make it explicitly clear that brokers and RIAs are to be held to a best interest standard for everything they sell, not just securities. It would be a travesty for the Commission to allow one of the few sleazoid BDs or RIAs to get away with fleecing investors just because some dodgy investment vehicle was labeled as an insurance product and not a “security.”

This oversight can be fixed by adding the words “or any financial product” after “securities” in the proposed rule. The first part of the rule would thus read:

(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 or any financial product 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.

Disclosure is NOT communication. Congress directed “simple and clear” disclosures.

Required disclosures are the traditional antidotes to the endemic information asymmetries in our financial markets. Alas, forcing disclosure is like forcing children to clean their room. They will reluctantly comply, if you are lucky. They still require constant oversight and will do the least they can get away with.

The statute calls for “simple and clear” disclosures. The proposed rule does not. “Reasonably disclose” is not the same. Section 913 directs the Commission to facilitate “simple and clear” disclosures as you note in footnote 211 and also on page 123. However, the phrase “simple and clear” does NOT appear anywhere else in the text of the proposed Regulation Best interest or in the proposed rule, nor is there any meaningful discussion as to why “simple and clear” was left out.

The examples on page 106 of the proposing release are excessively lawyerly and NOT “simple and clear.” “All recommendations will be made in a broker-dealer capacity unless otherwise expressly stated at the time of the recommendation.”” Can the average person with only a U.S. public high school education understand what this means? I doubt it.

I suggest “reasonably disclose in a *simple and clear* manner” in Regulation Best Interest.

The phrase “simple and clear” does not even appear in the proposed directions for Form CRS.⁷

⁷ The single use of the word simple in the entire set Form CRS directions is on page xvi:

“Regardless of your response to Item 7.B, you must state the following: “Visit Investor.gov for a free and simple search tool to research our firm and our financial professionals.””

Provide a tested model disclosure document.

The proposal leaves the form of the disclosures up to the firms and thus their lawyers. With all due respect, lawyers often fall into the trap of acting as if all the readers of disclosures have attended law school.⁸ That is not the case. What is simple and clear to an attorney is not simple and clear to the average citizen. Census data show that 11.6% of the adult population over 25 do not have even a high school diploma and 41.1% have not attended college.⁹ Even when conscientious lawyers try to write something “simple and clear,” it won’t be simple and clear to the most vulnerable investors with the least education.

Even worse, some firms will hire the best obfuscatory lawyers that money can buy to come up with disclosures that appear to meet the letter of the law while making a travesty of its spirit. Consumers shopping for advice will have to wade through all of them, or more likely ignore all of them because they will be written in repetitive and cumbersome legalese (like this rule proposal) and printed in a type font so small that most customers eyes will glaze over upon even attempting to read. Consider the typical “disclosures” that accompany a research report:¹⁰

⁸ I actually like lawyers. My father and grandfather were lawyers and I have met many fine lawyers over the years.

⁹ <https://www.census.gov/content/dam/Census/library/publications/2016/demo/p20-578.pdf>

¹⁰ I did not attempt to make this hard to read. This is what happened from a simple cut and paste of the screen shot of the disclosure.

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MJCO and MJSP also maintain policies and procedures to address Japanese regulatory requirements.

The Commission should follow the example set for Gramm Leach Bliley privacy notices or Truth in Lending Act disclosures in which the regulators actually gave examples of what the notices should look like.¹¹ These are simple and clear. Standardized disclosures will help investors to quickly understand the forms, and make it easy to compare one firm with another. Here is an example of what it could look like:

Relationship Summary	
<p>Our policy is that all recommendations we make will be in your best interest at the time of the recommendation based on what you have told us about your personal investment needs. You should be aware, however, that there are conflicts of interest that could affect our advice. In particular you should be aware of the following:</p>	
<p>Fees</p>	<p>We are paid on commission for the products you purchase or sell through us. This gives us a financial incentive to recommend that you engage in more transactions with us. See our fee schedule for more details.</p> <p>Or</p> <p>We charge a fee based on the assets we manage for you. This gives us a financial incentive to recommend that you entrust us with more assets to manage. See our fee schedule for more details.</p> <p>Or</p> <p>We charge an hourly fee. This gives us a financial incentive to spend more time to provide advice.</p> <p>Or</p>

¹¹ See https://www.ftc.gov/system/files/documents/rules/privacy-consumer-financial-information-financial-privacy-rule/privacymodelform_optout.pdf and <https://www.ftc.gov/sites/default/files/documents/reports/improving-consumer-mortgage-disclosures-empirical-assessment-current-and-prototype-disclosure-forms/samplecurrentforms.pdf>

	<p>We charge a flat fee for a financial plan. This gives us a financial incentive to do the least work necessary to produce the required plan.</p>
Principal capacity	<p>When you buy or sell a stock or bond through us, we may buy or sell it directly from you rather than send your order to an exchange or other market. We promise that the price we will give you is as good as or better than the price we would be able to get for you from any other dealer.</p>
Initial Public Offerings	<p>When we market initial public offerings we may receive payments from the issuer for doing so in addition to any commission we charge.</p>
Ongoing advice	<p>We are no under obligation to monitor your investments on an ongoing basis. We are not required to reach out to you or update our recommendations if your personal circumstances or market conditions change. We recommend that you check with us regularly to see how we can help you.</p> <p>Or</p> <p>We will monitor your investments on an ongoing basis in accordance with your instructions.</p>
Proprietary products	<p>We only recommend our own products. Products sold by others may or may not be better for you.</p>
Payment for order flow	<p>We also receive payments when we route an order from you to another broker or exchange. While we still have an obligation to get the best execution for your order, such payments may influence our judgment. See our order execution disclosure for more details.</p>
Other ways we make money	<p>We may also make money by lending you money to purchase financial products “on margin” or by lending out your securities and</p>

	<p>cash.</p> <p>We also sell insurance products on commission and provide commodity trading services.</p> <p>We may sell some of your personal data to other entities. See our Privacy Disclosure for more details.</p>
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Recall that the SEC has explicit testing authority under Dodd Frank §912 to engage in testing, and it should use this authority to come up with model disclosures. It should use this authority to come up with meaningful “simple and clear” disclosures.

Put the generic education into a separate document.

One of the defects in the proposed Form CRS is that it tries to combine generic investor education with specific information about the firm in question. This results in a document far longer than it needs to be. When customers attempt to compare different firms with each other, they will see lots of stuff they have seen before and be tempted to skip over the relevant parts. The obfuscators will use this to hide what they want to hide.

As an educator, I clearly believe that education is important. However, burying the relevant information among the boilerplate is a bad idea. It would be better to move the boilerplate to a separate educational document that would be required to be provided along with the Form CRS.

The costly record keeping requirements are unnecessary as self-interest will lead firms to keep proof of compliance.

The proposed record keeping requirements have a proposed initial cost of over \$4 billion and an annual compliance cost of over \$1 billion. The proposed record keeping requirement is extremely broad, in that it requires keeping “a record of all information collected from and provided to the retail customer.” The phrase “all information” is quite broad and could require the collection and retention of very large amount of information.

Much of the collected information is of a personal nature with all of the inherent data breach risks. Overly cautious compliance personal will err on the side of collecting too much information, driving up the cost. If a registered rep happens to mention a baseball score in a conversation with a client, the firm could be

required under a strict reading of the rule to record that information as it was provided to the retail customer.

Furthermore, these record keeping requirements are totally unnecessary. Under the new best interest standard, broker-dealers are vulnerable in arbitration to charges that they did not act in the best interest of their clients or did not fully disclose relevant conflicts of interest. Broker-dealers thus have an extremely strong financial incentive to retain whatever records necessary to document that they have done their duty. If they don't keep good records, they will lose in arbitration. Every time. Their self-interest will drive them to retain the appropriate proof that they are acting in the best interest of clients.

Adding an official record keeping requirement wastes regulatory enforcement resources as FINRA and the SEC will have to monitor the record keeping.

The record keeping requirements should be eliminated.

The “some retail customer” text in (a)(2)(ii)(A) is redundant to (a)(2)(ii)(B).

Section (a)(2)(ii)(A) calls for “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;”

While (a)(2)(ii)(B) requires “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;”

Clearly, if a recommendation is in the best interest of a *particular* retail customer (B), then it automatically satisfies the “some retail customer” standard in (A). I recommend getting rid of the redundancy. Keeping the redundancy in the rule drives up both compliance costs as firms make sure they have written policies and procedures in place and enforce those procedures in order to document compliance with the redundant section. Furthermore, FINRA and SEC staff time will be spent making sure firms comply with both A and B.

As discussed below, unnecessary redundancy is costly to everyone.

The proposing release is silent on how other jurisdictions deal with the problem. This may create legal problems for the Commission.

The Regulatory Flexibility Act requires a discussion of alternatives, and the proposing release discusses only three alternatives: Disclosure only, principles-based, and enhanced standards akin to DOL’s

stillborn BIC exemption. The proposing release does not examine the plethora of methods used in other countries to address the same conflicts of interest.

The United States is not the only jurisdiction that has to deal with the conflicts of interest. Despite all of the excess verbiage in the release, there is no discussion whatsoever about how other jurisdictions deal with the same conflicts of interest. This alone should get whatever rules come of this process thrown out for inadequate economic analysis and inadequate consideration of the alternatives.

Needless repetition won't save you at the DC Circuit. Mindless repetition signals weak arguments, not strong ones.

I know that the hardworking attorneys at the SEC are trying to make sure that they document that they have dotted all of the “i”s and crossed all the “t”s in the Administrative Procedures Act to avoid a defeat at the DC Circuit. However, the resulting proposals are filled with needless repetition. The end result is crossed eyes for the reader. So much for plain language.

This mindless repetition does not make the Commission’s case any stronger. Indeed, merely stating the same thing over and over again appears to be a cover up of a weak case. This is sad, because the Commissions’ case in this particular situation is actually quite compelling.

As discussed above, unnecessary redundancy is costly to everyone. The 407-page rule proposal for Regulation Best Interest is filled with numerous repetitive and unnecessary language. The 407 page proposing release repeats the same verbiage over and over again. The text recognizes this redundancy with numerous references to other sections of the text. Indeed, the phrase “as discussed” appears 113 times. To be more precise, here are a few examples:

As noted above: 44

As noted earlier: 10

As discussed above: 57

As discussed below: 13

As discussed earlier: 4

As discussed in more detail: 17

Establish, maintain, and enforce : 32

Unnecessary redundancy is costly to everyone. Unnecessary redundancy is costly to everyone.
Unnecessary redundancy is costly to everyone. Unnecessary redundancy is costly to everyone.
Unnecessary redundancy is costly to everyone. Unnecessary redundancy is costly to everyone.

Did I mention that unnecessary redundancy is costly to everyone?

I hope that some judge, when faced with reading all of this repetition, calls the Commission to task and points out that repeating the same thing over and over again does not prove a case, but instead appears to

be a subterfuge to cover up a weak one. Indeed, the compelling parts of the Commission’s case may get lost in the verbosity.

Even better, I call upon all of the individual Commissioners to put your feet down and refuse to support such overly verbose documents. Make it clear that you will not vote to advance any rule filing, no matter how good, that is such a lengthy, repetitive, and redundant parody of verbose bureaucratese. This will make your job easier.

Such excessively long documents could be construed as *prima facie* evidence that the Commission has excess resources and does not need any more to do its job. This makes it hard to convince Congress to give the SEC the additional resources it really does need to do its job right.¹²

Here is a minor suggestion to make these proposals easier to read: Stick the repetitive glunk in the footnotes. Instead of saying in the text “As discussed ...” or “as noted...” and then repeating previous verbiage verbatim *ad nauseum*, use a footnote. The footnote could say “This was described in more detail in section...” and the main text would not be corrupted by needlessly infuriating repetition.

Every rule proposal should have a simple and clear table summarizing the costs and benefits.

Performing a cost-benefit analysis is difficult because many of the costs and benefits are difficult to quantify. The Commission does a valiant job in attempting to quantify many of the compliance costs, but then buries them in the repetitive text of the proposing release, and nowhere provides a complete total. Shame on you. It makes it look like you are trying to hide something, which further erodes the Commission’s credibility. Every rule proposal should have a simple and clear table summarizing the quantifiable costs and benefits. Here is a sample for the costs.¹³

Regulation Best Interest				
Estimated costs				
		Estimated		
Section		Initial cost (\$ millions)	Annual cost (\$ millions)	Page reference

¹² Indeed, the sum total expenditures spent on the SEC since its founding in 1934 have been less than the investor losses from one Madoff. Congress has been penny wise and pound foolish in its perennial underfunding of the Commission.

¹³ I make no representation as to the completeness or accuracy of this list of all the costs from the rule filing. Any mistakes are another testament to the opaque nature of the rule proposal.

(a)(1)	Shall act in best interest			
(a)(2)(i)	Reasonably disclose	\$ 1,391.07	\$ 460.81	284
(a)(2)(ii)	Care Obligation			
(a)(2)(ii)(A)	Understand risks			
(a)(2)(ii)(B)	Reasonable basis to believe			
(a)(2)(ii)(C)	Series of transactions			
(a)(2)(iii)(A)	Policies and procedures for material conflicts	\$ 273.01	\$ 120.92	294
(a)(2)(iii)(A)	Policies and procedures for material conflicts from financial incentives			
240.17a-3 (25)	Record keeping	\$ 4,516.56	\$ 1,141.81	285
240.17a-4	Six year requirement			
Total		\$ 6,180.64	\$ 1,723.54	

Similar tables should be used for the benefits as well. As many of the benefits are difficult to quantify, this could be stated in the table itself.

This is obviously a major rule under SBREFA.

As mentioned in the proposing release, the Commission must advise the OMB as to whether this constitutes a major rule. With parts of the proposal costing more than \$5 billion up front, this obviously exceeds the \$100 million threshold, and the SEC should say so in this section.

Respectfully submitted,

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Here are my suggested edits to the text of the proposed rule, with additions underlined and deletions ~~struck out~~.

0.151-1 Regulation Best Interest.

(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 or any financial product 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.

(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 in a simple and clear manner 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:
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(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) The broker or dealer establishes, maintains, and enforces 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.

(b) Definitions. Unless otherwise provided, all terms used in this rule shall have the same meaning as in the [Securities Exchange Act of 1934]. In addition, the following definitions shall apply:

(1) Retail Customer means a person, or the legal representative of such person, who: (A) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and

(B) Uses the recommendation primarily for personal, family, or household purposes.

(2) 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 a natural person who is an associated person of a broker or dealer in connection with a recommendation.

§ 240.17a-3 Records to be made by certain exchange members, brokers and dealers.

~~(25) For each retail customer to whom a recommendation of any securities transaction or investment strategy involving securities is or will be provided:~~

~~(i) A record of all information collected from and provided to the retail customer pursuant to § 240.151-1, as well as the identity of each natural person who is an associated person, if any, responsible for the account.~~

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~~(ii) For purposes of this paragraph (a)(25), the neglect, refusal, or inability of the retail customer to provide or update any information required under paragraph (a)(25)(i) of this section shall excuse the broker, dealer, or associated person from obtaining that required information~~

§ 240.17a-4 Records to be preserved by certain exchange members, brokers and dealers.

* * * * *

(e)***

~~(5) All account record information required pursuant to § 240.17a-3(a)(17) and all records required pursuant to § 240.17a-3(a)(25), in each case until at least six years after the earlier of the date the account was closed or the date on which the information was collected, provided, replaced, or updated.~~