

November 5, 2018

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U.S. Securities and Exchange Commission

**Re: Follow-up to October Meeting on Regulation Best Interest Proposal**

The American Retirement Association (“ARA”) thanks the Securities and Exchange Commission (“Commission”) for the thought and effort dedicated to its regulatory package. We appreciate the ongoing opportunity to work with the Commission on these issues of great importance to our diverse membership of retirement marketplace participants. We are reaching out to follow-up on a few outstanding questions presented during our October 10<sup>th</sup> meeting.

As we discussed, we believe that a regulatory gap is presented when brokers who are not ERISA 3(21) or 3(38) fiduciaries provide recommendations to small plan fiduciaries. These non-professional, small plan fiduciaries often do not have independent financial or investment expertise and therefore are more likely to rely on broker-dealers’ recommendations when making investment decisions on behalf of their plan participants. In this way, small plan fiduciaries are akin to retail investors who at times lack financial literacy let alone expertise.<sup>1</sup>

**Q1. What need is there for regulation?**

**Answer:**

The potential for abuse presents itself when there is information asymmetry between the client and the broker - the latter of whom is incentivized to push higher commissioned products. Efficiency losses arise from these conflicting incentives, especially because the parties are imperfectly monitored. The Executive Office Report, “*The Effects of Conflicted Investment Advice on Retirement Savings*” finds that conflicted advice reduces investment returns by roughly 1 percent and that the total annual cost to retirement savers well exceeds \$17 billion. Chairman Clayton has voiced his concern for Mr. and Mrs. 401(k) and Main St. America. We simply ask that protection is afforded to all retirement vehicles not just non-ERISA 403(b)s and IRAs as plan participants are the ultimate beneficiaries of the plan assets.

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<sup>1</sup> This investor sophistication policy is already reflected in FINRA rules governing suitability obligations to institutional accounts (versus “non-institutional accounts”) in that a broker-dealer is exempt from its customer-specific suitability obligation, in part, if they have “a reasonable basis to believe that the institutional customer is *capable of evaluating the risks independently*, both in general and with regard to particular transactions and investment strategies.” It also is important to note that, where an institutional customer has delegated decision-making authority to an agent, such as an investment adviser or a bank trust department, Rule 2111(b) makes clear that the factors relevant to determining whether the customer meets the criteria for the institutional-customer exemption will be applied to the agent.



**Q2. *Why should the SEC and not the DOL fill this regulatory gap?***

**Answer:**

SEC action is necessary to preempt state legislators from filling the perceived void left in the wake of the DOL rule's vacatur – a patchwork of regulations is a bad outcome for the investment industry. The DOL's mission to foster, promote, and develop the welfare of retirees intersects with the SEC's own mission to protect investors. However, the DOL lacks jurisdiction over a significant portion of the retirement market, namely, amounts held in individual retirement accounts. In addition, the DOL has little experience in regulating the securities industry, and lacks the examination and enforcement resources that are necessary to promote compliance. We see this as an investor protection issue since these non-professional fiduciaries are themselves investors vulnerable to broker impropriety. To that end,, Chairman Clayton has expressed concern for small plan fiduciaries like his parent's family-owned business whose 401(k) plan was subject to multiple layers of undisclosed fees.<sup>2</sup>

**Q3. *What constitutes a "small" plan fiduciary?***

**Answer:**

The terms-of-art "institutional account" and "institutional investor" under FINRA Rules 2111 and 2210, respectively, are informative for purposes of defining "small" plan fiduciaries. FINRA's suitability rule (i.e., rule 2111) defines "institutional account" by reference to FINRA's "books and records" rule (i.e., rule 4512(c)) which sets the threshold for institutional status at \$50 million. The Department of Labor similarly looked to the \$50 million threshold in designing its now defunct rulemaking. However, rule drafters may be more inclined toward the employee-based definition of FINRA Rule 2210 governing institutional communications. Under that rule, "institutional investor" includes both:

(1) an employee benefit plan, or multiple employee benefit plans offered to employees of the same employer, that meet the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and in the aggregate have at least 100 participants, but does not include any participant of such plans; and

(2) a qualified plan, as defined in Section 3(a)(12)(C) of the Exchange Act, or multiple qualified plans offered to employees of the same employer, that in the aggregate have at least 100 participants, but does not include any participant of such plans

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<sup>2</sup> "Mr. Clayton, who came to the SEC from the law firm Sullivan & Cromwell, disputed what he called a limited portrayal of him as a Wall Street lawyer. He told a story about reviewing a 401(k) plan for his parents' business and finding "multiple layers of fees that were not disclosed." See [www.investmentnews.com/article/20170726/FREE/170729957/jay-clayton-says-sec-dol-can-give-market-clarity-on-fiduciary-rule](http://www.investmentnews.com/article/20170726/FREE/170729957/jay-clayton-says-sec-dol-can-give-market-clarity-on-fiduciary-rule)

**Q4. How are non-professional, small plan fiduciaries “retail customers”?**

**Answer:**

As the legal representative of a plan participant’s beneficial interest in the retirement plan, regulation best interest protections should apply at the plan level and flow through to the individual beneficiary - especially when those assets may sit in the plan for decades before being rolled over to an IRA.

The definition of “retail customer” includes 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 (such as retirement)

The regulation best interest proposal expands the definition of “retail customer” beyond the Section 913 study recommendation to include non-natural persons – specifically, legal representatives like a trustee or managing agent to a trust. Since the definition applies to persons, not simply natural persons, the trustee of an ERISA plan could qualify as a person satisfying the first prong.

Meanwhile, the second prong is satisfied in that recommendations made for retirement purposes constitute recommendations for personal, family or household purposes. While the proposal consciously excluded recommendations made for business or commercial purposes, there is ERISA precedent dictating that a plan is maintained for the benefit of the plan participants and not the employer sponsor. These recommendations should be covered by the proposed regulation since they will ultimately be used by the plan participants for personal, family, or household purposes.

**Q5. When do brokers provide “recommendations” to plan fiduciaries?**

**Answer:**

The Department of Labor much like the Commission has looked to FINRA guidance in determining the scope of the term “recommendation.” The term is not explicitly defined by the FINRA rules and is instead a case-by-case determination. The DOL, in looking to FINRA guidance, has found that actions like offering an investment selection menu to plan fiduciaries constitutes a “recommendation” (although it is unlikely to constitute investment advice under the 5-part test<sup>3</sup>, hence the gap). When brokers offer a single group annuity or only target-dates, they are quite clearly providing an investment recommendation.

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<sup>3</sup> The five-part test for determining functional fiduciary status under ERISA is defined as a person who does not have discretionary authority over plan assets and who, for compensation 1. Renders advice as to the value of securities or other property; 2. On a regular basis; 3. Pursuant to a mutual agreement; 4. The advice serves as the primary basis for investment decisions; and 5. The advice is individualized. All five prongs of the test must be met to be deemed a 3(21) investment fiduciary.

**Q6. How does the concept of “retail customer profile” apply in the plan fiduciary context?**

**Answer:**

While some have commented that the retail customer profile “has little to no applicability to [plan fiduciaries],”<sup>4</sup> we would beg to differ. When a broker is providing recommendations to a small plan fiduciary, there is a customer profile that should be considered albeit the focus is on the fiduciary’s needs and not any one particular employee participant. ERISA plan fiduciaries are subject to a prudence obligation when selecting plan investments. These plan fiduciaries must invest in a low cost diversified mix of assets. Brokers advise these plan fiduciaries as to the appropriate investment strategy and individual investments that will satisfy that strategy. As is more often the case, the plan is an individual account plan offering participants the opportunity to direct their investments, picking from a menu selected by the plan fiduciaries. ERISA Section 404(c) requires a small plan fiduciary to provide participants with a broad range of investment opportunities each of which is diversified and has materially different risk and return characteristics.<sup>5</sup> Brokers play a critical role in helping these plan fiduciaries provide a selection of investment options that is suitable for plan participants.

Additionally, ERISA plan fiduciaries are responsible for selecting qualified default investment alternatives (QDIAs) under participant-directed individual account plans when participants otherwise fail to exercise investment discretion. Target date funds (TDFs) are typically used for this purpose to fit within DOL regulatory parameters.<sup>6</sup> TDFs vary considerably with respect to providers, strategies, glide paths and investment-related fees and these differences can have a significant effect on investment performance. A prudent recommendation of a TDF requires a risk tolerance assessment particular to a given participant’s age (or alternatively, a target level of risk appropriate for participants of the plan taken as a whole). As such, the broker’s recommendation in meeting the needs of this profile is critically important to a small plan fiduciary.

**Q7. What protections does regulation best interest afford to these small plan fiduciaries that they do not already receive?**

**Answer:**

Protection under proposed regulation best interest would entitle plan fiduciaries to the care obligation and subject brokers to an explicit “duty to act in the **best interest** of the retail customer at the time a recommendation is made without placing the financial or other interest of the broker ahead of the interest of the retail customer.” Under the care obligation, brokers must “exercise reasonable diligence, care, skill, and **prudence**.” Notably, the Commission acknowledges in the proposal that prudence with its origins in ERISA case law is “not a term frequently used in the federal securities laws.” By capturing plan fiduciaries within the definition of retail customer, we are able to subject brokers to a prudence obligation that they would otherwise avoid due to the regulatory gap. Without protections afforded by 3(21) and 3(38) status under

<sup>4</sup> See <https://www.sec.gov/comments/s7-07-18/s70718-4185630-172656.pdf> (p. 16)

<sup>5</sup> Labor Reg. §2550.404c-1(b)(3).

<sup>6</sup> Labor Reg. §2550.404c-5(e)(i)&(ii).



ERISA or those afforded to “retail customers” under regulation best interest, brokers are subject to the mere suitability standard, if at all.

Furthermore, extending best interest protections to small plan fiduciaries would require brokers to implement policies and procedures pursuant to the conflict of interest obligation. Brokers that are not captured by ERISA as fiduciaries are otherwise not subject to a policies and procedures requirement.

With that said, the required disclosure under proposed regulation best interest’s disclosure and conflict of interest obligations is already captured by ERISA’s 408(b)-2 disclosure. It is for this reason that we suggest that compliance with ERISA’s disclosure scheme already applicable to broker-dealers when providing investment advice to small plan fiduciaries would satisfy regulation best interest’s disclosure requirements.

### Conclusion

We would welcome the opportunity to discuss these comments further with you should that be necessary. Please contact Brian Graff, Chief Executive Officer, at [BGraff@USARetirement.org](mailto:BGraff@USARetirement.org) or Doug Fisher, Director of Retirement Policy, at [DFisher@USARetirement.org](mailto:DFisher@USARetirement.org) if you have any questions.

Thank you for your time and consideration.

Sincerely,

/s/

Brian H. Graff, Esq., APM  
Chief Executive Officer  
American Retirement Association

/s/

Douglas Fisher, Esq.  
Director of Retirement Policy  
American Retirement Association

/s/

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CC:

Bradford Bartels  
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Rule Proposal	SEC/FINRA Rules (current)	ERISA (current)
<p><b>CARE OBLIGATION<sup>1</sup></b></p> <p>A broker, dealer or natural person who is an associated person of a broker or dealer, in making the recommendation, must exercise <b>reasonable diligence, care, skill, and prudence<sup>2</sup></b> to:</p> <p><i>There is over 40 years of history of DOL guidance and fiduciary litigation to consider in applying the prudent person rule.<sup>3</sup></i></p>	<p><b>SUITABILITY<sup>4</sup> (FINRA Rule 2111)<sup>5</sup></b></p> <p>Rule 2111 lists the three main suitability obligations for firms and associated persons.<sup>6</sup></p> <p><i>Many employers rely on their broker to guide them, but the broker is held to a <u>suitability standard</u>—not a fiduciary standard. Suitability relationships put emphasis on the success of the investment strategy, not the well-being of the plan sponsor or participants as a fiduciary relationship would mandate.<sup>7</sup></i></p>	<p><b>PRUDENT MAN RULE</b></p> <p>“...with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims”</p> <p><i>A regulatory gap is presented when brokers who are not ERISA 3(21) or 3(38) fiduciaries provide recommendations to small plan fiduciaries as</i></p>

<sup>1</sup> “[Reg Bi] would enhance the quality of recommendations provided by requiring broker-dealers make recommendations in the retail customer’s “best interest,” which incorporates and goes beyond a broker-dealer’s existing suitability obligations under the federal securities laws, and could not be satisfied through disclosure alone.” See: Regulation Best Interest, Exchange Act Release No. 34-83062,p. 10 (April 18, 2018)

<sup>2</sup> “Although the term “prudence” is not a term frequently used in the federal securities laws, the Commission believes that this term conveys the fundamental importance of conducting a proper evaluation of any securities recommendation in accordance with an objective standard of care.” See: Regulation Best Interest, Exchange Act Release No. 34-83062p. 134 (April 18, 2018)

<sup>3</sup> Reish, Fred. “Best Interest Standard and the Prudent Man Rule: Interesting Angles on the DOL’s Fiduciary Rule #9.” *The National Law Review*, 14 June 2016, [www.natlawreview.com/article/best-interest-standard-and-prudent-man-rule-interesting-angles-dol-s-fiduciary-rule](http://www.natlawreview.com/article/best-interest-standard-and-prudent-man-rule-interesting-angles-dol-s-fiduciary-rule).

<sup>4</sup> “If selling a financial product to the plan’s trustee, the advisor will be regulated by FINRA and will be subjected to a suitability standard of conduct, not a fiduciary standard. Such an advisor will not be a fiduciary under ERISA; however, such advisor will need to be cognizant of the EBSA regulations under ERISA section 408(b) that require any seller of financial products to make certain disclosures to the plan’s fiduciary(ies) in order to avoid committing a prohibited transaction in connection with such sale.” See [https://www.fi360.com/uploads/Article\\_2014\\_Rolph.pdf](https://www.fi360.com/uploads/Article_2014_Rolph.pdf)

<sup>5</sup> “The [FINRA variable annuity] rule does not cover recommendations regarding customers’ sales of variable annuities; qualified retirement plans (unless there is an individualized recommendation to a plan participant); subaccount reallocations; and payments made after the initial purchase. However, FINRA’s general suitability rule, FINRA Rule 2111...does apply in those situations.” Wrona, James S. “The Best of Both Worlds: A Fact-Based Analysis of the Legal Obligations of Investment Advisers and Broker-Dealers and a Framework for Enhanced Investor Protection.” *The Business Lawyer* 68, no. 1 (2012): 1-56; 30. <http://www.jstor.org/stable/23527074>.

<sup>6</sup> “While not an explicit requirement of FINRA’s suitability rule, FINRA and a number of cases have interpreted the suitability rule as requiring a broker-dealer to make recommendations that are “consistent with his customers’ best interests” or are not “clearly contrary to the best interest of the customer.” See: Regulation Best Interest, Exchange Act Release No. 34-83062,p. 14; n. 15 (April 18, 2018)

<sup>7</sup> “Suitability relationships incentivize brokers to suggest investments offering higher commission for themselves and greater revenue sharing potential for the other major 401(k) players like record-keeper, custodian and TPA. A conflict of interest then arises between the broker and plan sponsors/participants because brokers often do not offer advice in the best interest of their clients—rather brokers prioritize investment by the size of the commission payout and revenue sharing ability” See <https://www.forbes.com/sites/brianmenickella/2016/07/20/sneaky-401k-fees-you-didnt-know-you-were-paying/#253d451b3318>

		<i>they do not owe a standard of care to plan sponsors under ERISA.</i>
<ul style="list-style-type: none"> <li>understand the potential risks and rewards associated with the recommendation, and have a reasonable basis to believe that the recommendation <i>could be in the best interest of <u>at least some</u> retail customers</i></li> </ul>	<ul style="list-style-type: none"> <li><b>Reasonable-basis suitability</b> requires a broker to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors. Reasonable diligence must provide the firm or associated person with an understanding of the potential risks and rewards of the recommended security or strategy.</li> </ul>	<i>These non-professional small plan fiduciaries often do not have independent financial or investment expertise and therefore are more likely to rely on broker-dealers' recommendations when making investment decisions on behalf of their plan participants.</i>
<ul style="list-style-type: none"> <li>have a reasonable basis to believe that the recommendation <i>is in the best interest of a <u>particular</u> retail customer</i> based on the retail customer's investment profile as well as the potential risks and rewards associated with the recommendation</li> </ul>	<ul style="list-style-type: none"> <li><b>Customer-specific suitability</b> requires that a broker, based on a particular customer's investment profile, has a reasonable basis to believe that the recommendation is suitable for that customer. The broker must attempt to obtain and analyze a broad array of customer-specific factors to support this determination.</li> </ul>	<i>Many participants may not rollover their retirement plan accounts until they reach retirement age and therefore may hold their retirement savings in workplace retirement accounts for 30 to 40 years.</i>
<ul style="list-style-type: none"> <li>have a reasonable basis to believe that a <i>series of recommended transactions</i>, even if in the retail customer's best interest when viewed in isolation, <i>is <u>not excessive</u> and is in the retail customer's best interest when taken together</i> in light of the retail customer's investment profile</li> </ul>	<ul style="list-style-type: none"> <li><b>Quantitative suitability</b> requires a broker with actual or de facto control over a customer's account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, is not excessive and unsuitable for the customer when taken together in light of the customer's investment profile.</li> </ul>	<i>Protection should flow through to the plan participant as the plan is ultimately held for the benefit of the employees and not the employer.</i>

Rule Proposal	SEC/FINRA Rules (current)	ERISA (current)
<p><b>DISCLOSURE OBLIGATION<sup>8</sup></b></p> <p>Must disclose all material facts relating to the scope and terms of the relationship and all material conflicts of interest associated with a recommendation.</p>	<p><b>EXCHANGE ACT</b></p> <p>While broker-dealers are subject to a number of specific disclosure obligations when they effect certain customer transactions, and are subject to additional disclosure obligations under the antifraud provisions of the federal securities laws, broker-dealers <b>are not currently subject to an explicit and broad disclosure requirement under the Exchange Act.</b></p>	<p><b>ERISA 408b-2 Disclosure</b></p> <p>Requires plan service providers, including broker-dealers, to provide a comprehensive set of disclosures to retirement plan fiduciaries sufficient to allow plan fiduciaries to assess the merits of the service arrangement.</p>
<p>Material facts relating to the scope and terms of the relationship with the retail customer:</p> <ul style="list-style-type: none"> <li>▪ that the broker-dealer is acting in a broker-dealer capacity with respect to the recommendation;</li> <li>▪ fees and charges that apply to the retail customer's transactions, holdings, and accounts</li> <li>▪ type and scope of services provided by the broker-dealer, including, for example,</li> </ul>	<p><b>Exchange Act Rule 10b-10<sup>9</sup></b> generally requires a broker-dealer effecting customer transactions in securities (other than U.S. savings bonds or municipal securities) to provide written notification to the customer, at or before completion of the transaction, disclosing information specific to the transaction, including whether the broker-dealer is acting as agent or principal and its compensation, as well as any third-party remuneration it has received or will receive.</p>	<p>The information that must be disclosed under 408b-2 includes, among other things:</p> <ul style="list-style-type: none"> <li>▪ a description of the services the service provider will or reasonably expects to provide pursuant to the contract or arrangement</li> <li>▪ whether the service provider will provide services as a fiduciary under ERISA or as an investment adviser registered under the Investment Adviser Act of 1940, as amended</li> </ul>

<sup>8</sup> Under Regulation Best Interest, as proposed, a broker-dealer's obligation to disclose material conflicts of interest would resemble the duty to disclose material conflicts that has been imposed on broker-dealers found to be acting in a fiduciary capacity. See, e.g., *United States v. Szur*, 289 F.3d 200, 212 (2d Cir. 2002) (broker's fiduciary relationship with customer gave rise to a duty to disclose commissions to customer, which would have been relevant to customer's decision to purchase stock); *Arleen W. Hughes*, Exchange Act Release No. 4048 (Feb. 18, 1948) (Commission Opinion), *aff'd sub nom. Hughes v. Sec. & Exch. Comm'n*, 174 F.2d 969, 976 (D.C. Cir. 1949) (broker acted in the capacity of a fiduciary and, as such, broker was under a duty to make full disclosure of the nature and extent of her adverse interest, "including her cost of the securities and the best price at which the security might be purchased in the open market").

<sup>9</sup> 17 CFR 240.10b-10

<p>monitoring the performance of the retail customer's account</p>		<ul style="list-style-type: none"><li>▪ a description of all compensation the service provider, its affiliates, and subcontractors will receive or reasonably expect to receive directly from the plan client</li><li>▪ a description of all compensation the service provider, its affiliates, and subcontractors will receive or reasonably expect to receive from parties other than the plan client in connection with the contract or arrangement, including identification of the payer of such compensation and the</li><li>▪ services for which such compensation will be paid</li><li>▪ a description of all compensation that will be paid among the service provider, its affiliates, and</li><li>▪ subcontractors, including the payer of the compensation and the services for which such compensation is paid</li><li>▪ a description of any compensation the service provider, its affiliates, and subcontractors</li><li>▪ reasonably expect to receive in connection with termination of the contract or arrangement.</li></ul>
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<p>A broker-dealer <u>CANNOT</u> meet its Care Obligation through disclosure alone: “Where a broker-dealer is choosing among identical securities with different cost structures, we believe it would be inconsistent with the best interest obligation for the broker-dealer to recommend the more expensive alternative for the customer, even if the broker-dealer had disclosed that the product was higher cost and had policies and procedures reasonably designed to mitigate the conflict under the Conflict of Interest Obligations, as the broker-dealer would not have complied with its Care Obligation.”<sup>10</sup></p>	<p><b>Exchange Act Rules 15c1-5 and 15c1-6</b>, which require a broker-dealer to disclose in writing to the customer if it has any control, affiliation, or interest in a security it is offering or the issuer of such security.<sup>11</sup></p>	<p>The DOL disclosure requirements, as described above, <b>substantially overlap<sup>12</sup> with Regulation Best Interest’s disclosure requirements</b>. To the extent they apply to a broker-dealer, they would both require the broker-dealer to disclose the material facts concerning the relationship, including the services the broker-dealer will provide, whether the broker-dealer will act in a fiduciary capacity and the fees and expenses that will be charged.</p> <p>While the DOL disclosure requirements do not directly require disclosure of conflicts of interest, the ascribed purpose of the mandated disclosure of direct and indirect compensation is to provide plan fiduciaries with information to assess potential conflicts of interest.</p>
	<p>SRO rules apply to specific situations, such as FINRA Rule 2124 (<b>Net Transactions with Customers</b>); FINRA Rule 2262 (<b>Disclosure of Control Relationship with Issuer</b>), and FINRA Rule 2269 (<b>Disclosure of Participation or Interest in Primary or Secondary Distribution</b>)</p>	
	<p>Generally, under the antifraud provisions (<b>e.g., Rule 10b-5</b>), a broker-dealer’s duty to disclose material information to its customer is based upon the scope</p>	

<sup>10</sup> See Regulation Best Interest, Exchange Act Release No. 34-83062, p. 149 (April 18, 2018)

<sup>11</sup> 17 CFR 240.15c1-5 and 15c1-6.

<sup>12</sup> For example, the 408b-2 regulation and Form 5500 Schedule C require disclosures regarding soft-dollar arrangements and revenue sharing.<sup>27</sup> As a result, the DOL disclosure requirements and the disclosure requirement under Regulation Best Interest achieve the same ends. See 29 C.F.R. § 2550.408b-2(c)(1)(iv)(C)(3); 2017 Form 5500 Instructions at 25

	of the relationship with the customer, which is fact intensive. <sup>13</sup>	
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<sup>13</sup> See, e.g., supra note 87. Broker-dealers are liable under the antifraud provisions for failure to disclose material information to their customers when they have a duty to make such disclosure. See *Basic v. Levinson*, 485 U.S. 224, 239 n.17 (1988) (“Silence, absent a duty to disclose, is not misleading under Rule 10b-5.”); *Chiarella v. U.S.*, 445 U.S. 222, 228 (1980) (explaining that a failure to disclose material information is only fraudulent if there is a duty to make such disclosure arising out of “a fiduciary or other similar relation of trust and confidence”); *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999) (explaining that defendant is liable under Section 10(b) and Rule 10b-5 for material omissions “as to which he had a duty to speak”).

Rule Proposal	SEC/FINRA Rules (current)	ERISA (current)
<p><b>CONFLICT OF INTEREST OBLIGATION<sup>14</sup></b></p> <p>(1) Must establish, maintain, and enforce written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with recommendations</p>	<p>Broker-dealers are already subject both to liability for failure to supervise under Section 15(b)(4)(E)291 of the Exchange Act and to express supervision requirements under SRO rules, including the establishment of policies and procedures reasonably designed to prevent and detect violations of, and to achieve compliance with, the federal securities laws and regulations, as well as applicable SRO rules. <b>As such, we believe that a broker-dealer could comply with the policies and procedures requirement of Regulation Best Interest by adjusting its current systems of supervision and compliance, as opposed to creating new systems</b></p>	<p>There is no requirement to draft and implement conflict-of-interest policies and procedures under ERISA.</p> <p><i>The intent of the 408b-2 disclosure is to provide the plan fiduciary sufficient information to discern conflicts on their own accord.</i></p>
<p>(2) Must establish, maintain and enforce written policies and procedures reasonably designed to identify and disclose, and mitigate, or eliminate<sup>15</sup>, material conflicts of interest arising from financial incentives associated with such recommendations</p>	<p><b>Section 15(b)(4)(E) of the Exchange Act</b> authorizes the Commission to impose sanctions on a firm or any associated person that fails reasonably to supervise another person subject to its supervision that commits a violation of the federal securities laws.</p>	
<p>Reasonably designed policies generally should do the following<sup>16</sup>:</p>	<p><b>FINRA Rule 3110 (Supervision)</b> requires firms to establish and maintain systems to supervise the activities of its associated persons that are reasonably designed to achieve compliance with</p>	

<sup>14</sup> Under the proposed rule, broker-dealers would be permitted to exercise their judgment as to whether, for example, the conflict can be effectively disclosed (as discussed in Disclosure Obligation), determine what conflict mitigation methods may be appropriate, and determine whether or how to eliminate a conflict, if necessary, so long as the broker-dealer's policies and procedures are reasonably designed. Whether a broker-dealer's policies and procedures are reasonably designed to meet its Conflict of Interest Obligations will depend on the facts and circumstances of a given situation.

<sup>15</sup> "The rule does not mandate the absolute elimination of any particular conflicts, absent another requirement to do so. The absolute elimination of some particular conflicts could mean a broker-dealer may not receive compensation for its services, which is not the Commission's intent." See: Regulation Best Interest, Exchange Act Release No. 34-83062,p. 175 (April 18, 2018)

<sup>16</sup> Regulation Best Interest, Exchange Act Release No. 34-83062,p. 173 (April 18, 2018)

<ul style="list-style-type: none"><li>▪ define such material conflicts in a manner that is relevant to a broker-dealer's business (i.e., material conflicts of both the broker-dealer entity and natural persons who are associated persons of the broker-dealer), and in a way that enables employees to understand and identify conflicts of interest</li><li>▪ establish a structure for identifying the types of material conflicts that the broker-dealer (and natural persons who are associated persons of the broker-dealer) may face, and whether such conflicts arise from financial incentives</li><li>▪ establish a structure to identify conflicts in the broker-dealer's business as it evolves</li><li>▪ provide for an ongoing (e.g., based on changes in the broker-dealer's business or organizational structure, changes in compensation incentive structures, and introduction of new products or services) and regular, periodic (e.g., annual) review for the identification of conflicts associated with the broker-dealer's business</li><li>▪ establish training procedures regarding the broker-dealer's material conflicts of interest, including material conflicts of natural persons who are associated persons of the broker-dealer, how to identify such material conflicts of interest (and material conflicts arising from financial incentives), as well as defining employees' roles and responsibilities with respect to identifying such material conflicts of interest".</li></ul>	applicable securities laws and regulations and FINRA rules.	
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**Specific 401(k) example**<sup>17</sup>: A firm wants the benefits of a 401(k). They have seen an advertisement that John Hancock is a big player in this market and the name is well known. The Hancock plan salesperson comes out and recommends their plan. Here are some issues that are permitted under the suitability standard that can negatively impact the participants of the plan:

1. The advisor recommends a lineup of funds out of the 622 that Hancock offers. The plan sponsor just wants a "good mix" and relies on the "advisor" for what he/she thinks would be good. Hancock, like others, offers up to 9 options of the same fund all with different level of fees. The advisor recommends a number of the Hancock funds that have fees on the higher end. Under the suitability rule, the advisor is under no duty to disclose this or to recommend the lowest cost options.
2. The Hancock Target Date Funds (TDF) are included in the lineup of options and the salesperson highly recommends this concept to the employees. Most of the participants pick the TDF's. The advisor does not disclose that these funds have been around less than 3 years so there is little ability for participants to adequately judge the managers' effectiveness. Nor did the advisor later disclose that Morningstar evaluated TDF's and found that the Hancock funds are among the worst of all the mixed funds offered. Nor was it disclosed to the plan sponsor that Target Date Analytics, a firm dedicated to benchmarking TDF's, rates the Hancock offerings an "F" in the area of fees, due to their high costs compared to others.
3. The advisor is not required to mention that the record keeping and TPA services could be obtained from a competitor for less cost. Nor would the advisor discuss the options of bundled, unbundled or alliance options for service providers. The advisor works for Hancock and that is where the loyalty lies.

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<sup>17</sup> See [http://www.401khelpcenter.com/401k/chamberlain\\_401k\\_suitability\\_fiduciary.html#.W9nH3pNKiUk](http://www.401khelpcenter.com/401k/chamberlain_401k_suitability_fiduciary.html#.W9nH3pNKiUk)

<sup>18</sup> <https://www.employeebenefitsinsider.com/blog/understanding-a-401k-plans-fiduciary-hierarchy-can-make-it-easier-for-employers-to-meet-fiduciary-responsibilities>