

**Howard University School of Law
Investor Justice and Education Clinic
2900 Van Ness St. NW
Room 105, Notre Dame Hall
Washington, DC 20008**



February 20, 2019

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

RE: Comments on the Importance of Defining the Standards within the Proposed Best Interest Rule and its Effects on the Behaviors of Broker-Dealers; Regulation Best Interest Release No. 34-83062; File Number S7-07-18

Dear Mr. Fields:

The Howard University School of Law - Investor Justice and Education Clinic (“IJEC”) appreciates the opportunity to submit comments on the SEC’s proposed Best Interest Rule. The IJEC is one of the investor protection and education clinics initially funded with a generous grant from the FINRA Investor Education Foundation and commenced operations in Fall 2010. We are very proud of our record of providing free legal services to the underserved small investor community, as well as conducting investor education programs for schools, churches, senior citizen communities, and other organizations. The IJEC’s clients and education program participants include many senior citizens and working individuals with limited financial resources who cannot afford to hire counsel to protect their interests when dealing with financially sophisticated financial professionals and companies.

The IJEC and our small investor clients have a strong interest in the SEC 's proposed Best Interest Rule which, if adopted, will govern the conduct of broker-dealers and have a tremendous impact on the clients we serve. Since we advise many small investors involved in FINRA-DR arbitration cases against broker-dealers, we know firsthand the many critical issues faced by small investors when they deal with broker-dealers. It is our desire in this comment letter to share our insights with the SEC so that you can take them into consideration when finalizing the Best Interest rule to make it effective in protecting the interest of small and other investors.

This Comment Letter will inform you of some of the issues our small investor clients face when dealing with broker-dealers, and the impact the proposed rule may have on small investors' awareness of the amount and type of information and advice customers should expect from broker-dealers. We will also provide our recommendations for making the rule more effective to protect small investors for the Commission to consider.

First, our small investor clients are typically financially unsophisticated novice investors. When these investors deal with broker-dealers usually do not understand or appreciate the differences in the suitability standard that typically applies to broker-dealers and the fiduciary duty standard that applies to investment advisers. Our small investor clients almost always believe that broker-dealers owe them a duty of loyalty, and must always put the interest of the customer ahead of the interest of the broker-dealer. In short, small investors typically believe that their brokers are in essence also their investment advisers and, as such, owe them fiduciary duties of care and loyalty. These customers are surprised to learn, after investment losses occur or unnecessary fees are charged, that brokers are typically not held to the higher fiduciary duty standards of investment advisers. This problem is even more prevalent when many broker-

dealers use terms in customer agreements and other documents like “financial advisor” and “advisory fees”, that give customers the understandable belief that the broker is also their investment advisor that has a duty to work in the customers best interest and place the customers interest ahead of the broker’s interest.

Although it is our firm belief that the best protection for small investors is for broker-dealers to be held to the higher fiduciary duty standard of investment advisers, we believe that the Commissions proposed Best Interest is a step in the right direction to protecting small investors when they deal with broker-dealers. In this regard, the rule places express obligations on broker-dealers and their associated persons to provide recommendations that are in the best interest of retail customers. This would require broker-dealers and associated persons to act in the best interests of their retail customers when recommending securities, and to not place their own financial or other interests ahead of the interest of customers. However, there are several things the Commission can do to strengthen the Best Interest rule. The Commission should consider clarifying certain terms in the proposed rule such as “material” and “best interest” so that investors and broker-dealers will have more certainty regarding the requirements of the rule, and requires that broker-dealers proactively explain the terms and requirements to investors before executing customer agreements and trades.

The IJEC represents and advises many novice investors with limited means and education who often cannot afford attorneys, financial advisers, accountants, and other professionals to help them to understand the meaning of technical contractual terms. Therefore we believe it should be the responsibility of brokers, who are normally most small investors’ first contact with an investment professional, to proactively educate small retail investors to help them fully understand these terms before customer agreements and trades are executed.

We recently represented an elderly investor who, at the recommendation of her broker-dealer, sold liquid mutual fund investments in her retirement account to invest in complex long-term illiquid annuities with high surrender charges and other fees. This retiree was provided with voluminous documentation containing many complex terms that she simply did not understand. As a result, when the retiree needed her money for short term retirement living expenses she was surprised to learn that she would incur substantial surrender charges. This broker-dealer clearly placed its best interest of receiving substantial compensation ahead of this investor's retirement needs. In doing so, the broker did not fully explain all of the complex terms and considerable charges and fees to our client. The proposed Best Interest Rule, with our recommended revisions, may have helped to prevent our client from losing money since her broker-dealer would have been required to consider the retiree's best interests ahead of the broker's interest, and more fully explain the terms, charges, and risks associated with the annuity. With this knowledge, our client would likely have not followed the brokers recommendation and kept her mutual fund investments and avoided the ill-advised annuities.

This retiree was financially unable to afford lawyers, accountants, or other professionals who could have helped her navigate the complexities of annuities and other financial products. If the Best Interest rule were in effect then at least the one professional the retiree relied upon for advice (her broker) would have been required to act in her best interest and not place its own interest in earning lucrative fees for selling the annuities ahead of the investor's best interest. Fortunately for this retiree, the IJEC took her case and was able to recover all of her surrender charges in a negotiated settlement after filing a FINRA-DR arbitration case.

We will now provide some observations regarding the current version of the Proposed Best Interest rule. The rule addresses the question of whether broker-dealers should be held to a higher standard of conduct when making securities recommendations to retail customers. We agree that brokers should be held to a higher standard. However, we believe brokers should be held to the higher fiduciary duty standard that applies to investment advisers. In any event, we believe the Commission's proposed Best Interest rule is a step in the right direction and will provide small retail customers with more protection than currently exist under the suitability standard. Broker-dealers are already subject to many federal, state, and self-regulatory organization rules and regulations, such as the suitability rule and rules concerning certain conflicts of interest. We think broker-dealers should be required to only make recommendations that are suitable for customers and clearly in the best interest of the customer. The Commission's proposed rule is a step in the right direction and can be made even more effective if the Commission were to include our recommended revisions to the rule.

Regarding the disclosure obligation in the proposed Best Interest rule which states that the "best interest" standard shall be satisfied if the broker-dealer reasonably discloses to the retail customer, in writing, the material facts (including all material conflicts of interest) that are associated with the recommendation. We agree that at a minimum the broker should be required to make such disclosures. However, we recommend that the Commission consider requiring that the disclosures be made prior to the recommendation, rather than at the time of the recommendation. This will allow the retail customer time to review the disclosures and make a more informed determination as to whether the broker is acting in the customer's best interest. (Of course we believe that that brokers should avoid having any conflicts of interest with their customers, whether disclosed or not.)

The Commission's duty of care obligation in the proposed Best Interest rule provides that when making a recommendation of any securities transaction or investment strategy to a retail customer the broker must exercise reasonable diligence, care, skill, and prudence to (1) 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; (2) 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 (3) 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.

The Commission's duty of care provision in the proposed rule, which appears to simply repeat some existing requirements (such as the reasonable basis standard for recommendations) would help protect investors. We also recommend that the SEC include a duty of loyalty in the rule to provide even more protection for investors. By doing so the standards of the Best Interest rule would be closer to the fiduciary duty standard that we believe is in the best interest of investors.

In conclusion, we agree that the Commission's proposed "Best Interest" rule would be a meaningful step in the right direction of enhancing investor protection and improving the relationship between investors and brokers. We further believe that if the Commission were to adopt our proposals then the Best Interest rule would be more effective. In addition, we think

further training should be required of broker-dealers and associated persons to ensure that they understand the requirements of the proposed rule, including what is meant by “best interest”.

Respectfully Submitted by:

The Investor Justice & Education Clinic

Cc: IJEC Students Jon’Mel Davenport and Dane Dixon