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August 7, 2018

Brent J. Fields, Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: File Number S7-09-18

Proposed Regulation Best Interest for Broker-Dealers, Regulation CRS for broker-dealers and investment advisers, and interpretive guidance on an investment adviser's fiduciary standard

Dear Mr. Fields:

Prudential Financial, Inc. ("Prudential") appreciates the opportunity to comment on the Securities and Exchange Commission's (the "Commission") proposals to adopt Regulation Best Interest for Broker-Dealers ("Reg BI"), Regulation CRS for broker-dealers and investment advisers, and interpretive guidance on an investment adviser's fiduciary standard (collectively, the "Proposals").<sup>1</sup> Prudential thanks the Commission for the significant effort that has been undertaken to develop the Proposals. While we believe (and will recommend here) that certain improvements should be made to the Proposals, Prudential generally is supportive of the Proposals and believes that their adoption, particularly with regard to Reg BI, would provide important protections to retail customers that would be stronger than the current standard. Furthermore, we appreciate the SEC's stated objective of coordinating with and engaging fellow regulators, including state insurance regulators. We are aware that some have criticized the Proposals for supposedly failing to provide sufficient protection to retail customers. In our view, such criticisms are not justified since the Proposals, taken as a whole, reflect a genuine effort by the Commission to create workable regulatory standards that, with the revisions and clarifications discussed below, would provide for appropriate investor protections without resulting in loss of access to the critical investment products and services that retail consumers need.

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<sup>1</sup> See Reg BI, Securities Exchange Act Release No. 83062 (Apr. 18, 2018), 83 Fed. Reg. 21574 (May 9, 2018); Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles, Securities Exchange Act Release No. 83063, Investment Advisers Act Release No. 4888 (Apr. 18, 2018), 83 Fed. Reg. 21416 (May 9, 2018); Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, Investment Advisers Act Release No. 4889 (Apr. 18, 2018), 83 Fed. Reg. 21203 (May 9, 2018).

## I. Introduction

### A. Who We Are

Established in 1875, Prudential is a financial services leader with a 140-year history of helping Americans secure their financial future and achieve financial wellness. At a time when workers are facing a steady reduction in coverage and benefits provided by defined benefit plans, our subsidiaries and affiliates offer a wide array of financial products and services in the marketplace that help individuals and their families provide for their financial futures. These financial products and services include fixed and variable annuities, life insurance, including variable life insurance, retirement-related services, mutual funds, investment advisory programs, and investment management products, among other products and services. We offer these products and services to individual and institutional customers through proprietary and third-party distribution networks, which also include broker-dealers and investment advisers.

### B. Overview of Principal Comments

Fundamentally, we believe that regulation should provide consumer protections while ensuring retail customers can continue to have access to the quality products and services they need, and pay for them in the manner (transaction-based or fee-based) that meets their needs. We, therefore, appreciate and support a workable best interest standard that, at the same time, will not create unnecessary barriers for consumers to access critically needed products and services.

In considering the Commission's request for comments and our response, we have focused on whether the Proposals would achieve the Commission's objectives, which we support, as stated by Chairman Clayton, in his public statement, dated April 18, 2018:

First, enhance retail investor protection and decision making by:

- Raising the standard of conduct for broker-dealers when they provide recommendations to retail investors, and
- Reaffirming and in some instances clarifying the terms of the relationships that retail investors have with their investment professionals.

Second, preserve retail investor access (in terms of choice and cost) to a variety of types of investment services and investment products.

Third, raise retail investor awareness of whether they are transacting with registered financial professionals.<sup>2</sup>

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<sup>2</sup><https://www.sec.gov/news/public-statement/clayton-overview-standards-conduct-investment-professionals-rulemaking>

As we explain below, we strongly urge the Commission to revise or clarify certain aspects of the Proposals to avoid the unintended practical consequences of reducing access to securities products and advice at precisely the moment they are most urgently needed by American investors, and raising the costs of products and services that ultimately would be available to them.

Specifically, we recommend modifications to Reg BI to: (i) include an express definition of “recommendation”; (ii) redefine “retail customer” and “retail investor” to identify more precisely the individuals who are actually in need of and would benefit from the protections afforded by Reg BI and Form CRS; (iii) clarify certain aspects of the Disclosure, Care and Conflicts of Interest Obligations, including adopting an express definition of “material conflict of interest,” and including clearer direction regarding whether and how certain material conflicts of interest involving financial incentives can be effectively disclosed and mitigated; (iv) make Reg BI recordkeeping requirements consistent with existing rules; and (v) develop a Form CRS that is less prescriptive and allows firms to tailor the content to be more directly related to the particular products and services they offer and, therefore, more meaningful to their customers. Additionally, we request certain clarifications to the interpretation of investment advisers’ fiduciary obligations.

With these revisions, we feel that the Proposals could achieve the right balance between providing consumer protections and ensuring retail customers continue to have access to the quality securities products and services they need. In this regard, we offer the following comments.

## II. **Reg BI: Statement of Obligation**

The Proposal states:

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>3</sup>

Reg BI is deemed satisfied if a broker-dealer fulfills Disclosure, Care, and Conflict of Interest Obligations. We understand that compliance will turn on the facts and circumstances of the particular recommendation and the particular retail customer, along with the facts and circumstances of how the components of Reg BI are satisfied. Overall, Prudential is supportive of the Commission’s efforts to introduce a heightened, “best interest,” standard of care for broker-

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<sup>3</sup> Exchange Act Release No. 83062 (Apr. 18, 2018) at p. 404, available at <https://www.sec.gov/rules/proposed/2018/34-83602.pdf>; 17 CFR §204.15/-1

dealers (rather than a uniform fiduciary standard with investment advisers), built upon existing rules and regulations, and relying primarily upon principles-based obligations. We note that Reg BI extends to all retail customer accounts—not just retirement accounts—and therefore extends protections to a larger universe of customers than “retirement investors” under the Department of Labor’s former and now vacated fiduciary rule and related prohibited transactions exemptions. We support a standard that preserves investor choice and access to products, services, service providers, and payment options, as noted by our comments in this letter. We believe that it is important to preserve access to commission-based accounts, which, for retail customers who buy and hold securities, can be more cost-effective than fee-based accounts. In fee-based accounts, fees are based on a percentage of account assets and are more appropriate for investors who engage in at least a moderate level of trading activity. The proposed language would accomplish the goal of a financial professional’s basing his or her recommendations on the retail customer’s interests, thereby putting the retail customer’s interests first, while preserving the individual investor’s choice of whether actively to manage some or all of his or her own investments with the advice of financial professionals acting on a commission basis, or to establish an investment advisory relationship.

### III. **Reg BI: Definition of Recommendation**

We note that “recommendation” is not expressly defined in Reg BI. We appreciate the Commission’s statements that it would interpret the concept of a recommendation consistent with existing broker-dealer regulation under the federal securities laws and FINRA Rule 2111 and that broker-dealers may rely on existing guidance and interpretations. The Commission also states that, consistent with FINRA Rule 2111, Suitability, certain communications generally would not constitute recommendations as long as they do not include (standing alone or in combination with other communications) a recommendation of a particular security or securities. Finally, the Commission states that providing general investor education or limited investment analysis tools would not be a recommendation.<sup>4</sup> Given the critical role that a recommendation plays in complying with Reg BI, we urge the Commission, for the avoidance of doubt, to adopt an express definition of “recommendation” that would codify this important guidance and, in so doing, also define the phrase, “investment strategy involving securities,” in proposed 17 CFR §240.15l-1(b). We offer the definition provided in FINRA Rule 2111.03, Recommended Strategies, as a basis for defining the phrase for purpose of Reg BI.<sup>5</sup> For a definition of “recommendation,” we propose the following:

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<sup>4</sup> Release No. 83062 at p. 76.

<sup>5</sup> FINRA Rule 2111.03 states:

The phrase “investment strategy involving a security or securities” used in this Rule is to be interpreted broadly and would include, among other things, an explicit recommendation to hold a security or securities. However, the following communications are excluded from the coverage of Rule 2111 as long as they do not include (standing alone or in combination with other communications) a recommendation of a particular security or securities:

Recommendation means one or more statements or acts directed specifically to a retail customer by an associated person of a broker or dealer, or by a broker or dealer where no associated person is involved that (1) would reasonably be interpreted by the retail customer to be individually tailored advice with respect to an investment decision and (2) if acted upon, would result in a retail customer's entering into or refraining from entering into an investment transaction in accordance with that advice.

A recommendation does not include: (A) general factual information to the public, such as advertisements, marketing materials or the use of interactive tools that provide a retail customer with the means to estimate future income needs or compare different types of products, including non-personalized calls to action; (B) general education information, including market commentary and information clearly stating that is provided for institutional clients, regarding securities or strategies involving securities and (C) general administrative services to the retail customer. General administrative services to the retail customer would include, but not be limited to: (1) the provision of an objective description of the terms, features or benefits of the security or strategy involving securities, including access to tools that provide personalized factual information about the retail customer's investments and investment options; (2) any objective notification or provision of information related to a retail customer's rights under an in-force policy, contract or advisory agreement; and (3) the provision of any material or information required to be provided to a retail customer under applicable laws or regulations.

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- (a) General financial and investment information, including (i) basic investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment, (ii) historic differences in the return of asset classes (e.g., equities, bonds, or cash) based on standard market indices, (iii) effects of inflation, (iv) estimates of future retirement income needs, and (v) assessment of a customer's investment profile;
- (b) Descriptive information about an employer-sponsored retirement or benefit plan, participation in the plan, the benefits of plan participation, and the investment options available under the plan;
- (c) Asset allocation models that are (i) based on generally accepted investment theory, (ii) accompanied by disclosures of all material facts and assumptions that may affect a reasonable investor's assessment of the asset allocation model or any report generated by such model, and (iii) in compliance with [Rule 2214](#) (Requirements for the Use of Investment Analysis Tools) if the asset allocation model is an "investment analysis tool" covered by [Rule 2214](#); and
- (d) Interactive investment materials that incorporate the above.

**IV. Reg BI: Definition of Retail Customer**

The Proposal states:

*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.<sup>6</sup>

This definition should be harmonized with other regulatory definitions (e.g., Section 913(g) of Dodd Frank Act; FINRA Rules 2111, 2210, and 4512). The currently proposed definition, which differs from existing definitions established by other rules, would cause compliance and operational burdens, including inconsistent and overlapping internal procedures, and cause customer confusion.

We propose that, as discussed in more detail below, “retail customer” should be redefined to be more consistent with FINRA’s definition of “retail investor” in FINRA Rule 2210 (Communications with the Public) and expressly exclude “institutional investors,” as firms have operated successfully under these definitions and already have in place policies and procedures reasonably designed to achieve compliance with this definition in connection with suitability determinations, communications with the public, and disclosures. Additionally, since “primarily” is not defined and could be subject to differing interpretations, the Commission should clarify what it means in the context of Reg BI and confirm that the limitation means that the recommendation applies to an account that will be used primarily for personal, family or household purposes, rather than for a business purpose, as distinguished from requiring that a determination be made as to whether each recommendation is being used for such purposes. This will simplify administrative implementation of the rule since, once it is known that the account is intended to be used “primarily” for personal, family or household purposes, it follows logically that recommendations for securities transactions or investment strategies involving securities investments in connection with that account would be subject to the protections of Reg BI.

Under FINRA Rule 2210, a “retail investor” means any person other than an institutional investor, regardless of whether the person has an account with a member.” In substance, a revised definition in Reg BI should state:

*Retail customer* means a natural person (an individual) who receives a

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<sup>6</sup> Release No. 83062 at p. 406; 17 CFR §240.151-1(b)(1).

recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or associated person of a broker or dealer, and the account is intended to be used primarily for personal, family or household purposes, or trusts or other entities established by natural persons for such purposes, and the legal representatives of such persons who are not institutional investors.

*Retail customer* does not include the following institutional investors:

- (A) a bank, savings and loan association, insurance company or registered investment company;
- (B) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or
- (C) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least \$50 million<sup>7</sup>.
- (D) governmental entity or subdivision thereof;
- (E) 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;
- (F) 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;
- (G) FINRA member or registered person of such a member; and
- (H) person acting solely on behalf of any such institutional investor.

Those excluded are sophisticated professionals or individuals who have sufficient knowledge and expertise in financial and business matters to make them capable of evaluating the merits and risks of a prospective investment. Specifically, institutional investors have access to detailed information from investment providers that addresses the types of information that would be provided to comply with Reg BI's Disclosure Obligation or Form CRS.

We also seek clarification from the Commission that retirement plan representatives (plan sponsors, trustees, other fiduciaries, consultants and advisors) are not retail customers, because any recommendation they might receive would be for business or commercial purposes, not for personal, family or household purposes.

We also urge the Commission to clarify that "retail customer" should not include participants in Section 401(a), Section 401(k), Section 403(b) and Section 457 plans ("Plans") who do not have access to self-directed investment options. Those Plan participants should be excluded because, as they do not have investment authority under the Plan, they would not be using any recommendation they might receive for the purposes described in the retail customer definition.

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<sup>7</sup> See FINRA Rule 4512(c).

**V. Reg BI: Disclosure Obligation**

The Proposal states:

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 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.<sup>8</sup>

The Commission explains that, to meet this Disclosure Obligation, the Commission would generally consider the following to be examples of material facts relating to the scope and terms of the relationship with the retail customer: “(i) that the broker-dealer is acting in a broker-dealer capacity with respect to the recommendation; (ii) fees and charges that apply to the retail customer’s transactions, holdings, and accounts; and (iii) type and scope of services provided by the broker-dealer, including, for example, monitoring the performance of the retail customer’s account.”<sup>9</sup> We agree with the Commission’s approach that would permit broker-dealers to use a “layered approach” in disclosing material facts about recommendations, including by building on proposed Form CRS, and applaud the Commission’s determination “to provide flexibility in the form and manner, and the timing and frequency, of the disclosure” that is provided “prior to or at the time of” the recommendation. However, we request that the Commission clarify certain aspects of the Disclosure Obligation:

- The Commission states:

[W]e would like to emphasize the importance of determining the appropriate timing and frequency of disclosures that may be effectively provided “prior to or at the time of” the recommendation, but which may be achieved through a variety of approaches: (1) at the beginning of a relationship (e.g., in a relationship guide, such as or in addition to the Relationship Summary, or in written communications with the retail customer, such as the account opening agreement); (2) on a regular or periodic basis (e.g., on a quarterly or annual basis, when any previously disclosed information becomes materially inaccurate, or when there is new relevant material information); (3) at other points, such as before making a particular recommendation or at the point of sale; and/or (4) at multiple points in the relationship or through a layered approach to disclosure. For example, a broker-dealer may determine that

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<sup>8</sup> Exchange Act Release No. 83062 (Apr. 18, 2018) at p. 404, available at <https://www.sec.gov/rules/proposed/2018/34-83602.pdf>; 17 CFR §240.15l-1(a)(2)(i).

<sup>9</sup> Release No. 83062 at pp. 103-104.

certain disclosures may be most effective if they are made at multiple points in the relationship or, if pursuant to a layered approach to disclosure, certain material facts are conveyed in a more general manner in an initial written disclosure and followed by more specific information in a subsequent disclosure, which may be at the time of the recommendation or even after the recommendation (i.e., in the trade confirmation).<sup>10</sup>

Since “at the point of sale” is but one of a variety of acceptable approaches, we understand, and ask the Commission to clarify, that the Commission is not mandating a point of sale or point of recommendation disclosure obligation, which would impose substantial administrative, financial, and supervisory burdens on broker-dealers. Rather, a broker-dealer has flexibility to determine the form and manner, and the timing and frequency, of the disclosure. This may include certain disclosures after the recommendation, such as in a trade confirmation, if such subsequent disclosure, together with any initial written disclosures made, constitute “reasonable” disclosure in satisfaction of the Disclosure Obligation.

- We ask that the Commission address more specifically the important role that a broker-dealer’s website and other forms of electronic communication could play in satisfying the Disclosure Obligation. For example, a broker-dealer’s initial written communication could be sent to retail customers, via email, informing them of the information that may be found on its website, designed to comply with the Disclosure Obligation, and how to access such information (e.g., a link or URL). This approach should be deemed to comply with the Disclosure Obligation and has the distinct advantages of facilitating timely updates and providing the relevant information to retail customers on a continuous basis. Retail customers would be able to access the disclosures when and where they choose, including “prior to or at the time of such recommendation.” As found by the Pew Research Center, “Today, roughly nine-in-ten American adults use the internet.”<sup>11</sup> For any retail customers who have not consented to transact through the internet, broker-dealers would be able to devise alternative delivery mechanisms, including, for example, via U.S. mail or in person delivery.

- We ask that the Commission confirm that the Disclosure Obligation does not apply to prospective retail customers who do not have an existing brokerage relationship with the broker-dealer (albeit they become customers subsequently to whom, at that later point, in the event of a recommendation, as defined above, the Disclosure Obligation would apply).

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<sup>10</sup> Release No. 83062 at pp. 119-120.

<sup>11</sup> “Internet/Broadband Fact Sheet,” Pew Research Center, Washington, D.C. (July 5, 2018), <http://www.pewinternet.org/fact-sheet/internet-broadband>.

- More guidance is needed with respect to the required fee disclosure. We ask that the Commissioner allow disclosure of a range of fees. Clarity is needed regarding the application of the Disclosure Obligation to dually-registered broker-dealers and investment advisers and dual-hatted personnel as well as what and how frequently disclosure is required to put a retail customer on notice of the capacity in which a dually-registered broker-dealer is acting.

- We ask that the Commission confirm that a broker-dealer may satisfy its obligation to supervise the disclosure required under Reg BI by: (i) providing adequate training to associated persons regarding their disclosure obligations; (ii) making available to associated persons the required disclosure form regarding the broker-dealer and its policies that is approved by the broker-dealer; and (iii) documenting that such disclosure form was delivered to the retail customer that purchased the product.

#### VI. **Reg BI: Care Obligation**

The Proposal states:

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: (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.<sup>12</sup>

As proposed, it is difficult to determine how a broker-dealer must weigh financial factors when applying the Care Obligation, especially since, as drafted, disclosure alone does not satisfy the obligation. The Commission states:

Furthermore, we do not believe a broker-dealer could meet its Care Obligation through disclosure alone. Thus, for example, 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

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<sup>12</sup> Release No. 83062 at pp. 404-405; 17 CFR §240.15l-1(a)(2)(ii).

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. Such a recommendation, disclosure aside, would still need to be in the best interest of a retail customer, and we do not believe it would be in the best interest of a retail customer to recommend a higher-cost product **if all other facts are equal**. (Emphasis added.)<sup>13</sup>

The Commission's position hinges upon accepting that the securities are "identical" and "all facts are equal." In our view, those assumptions are faulty because, as is often the case, two securities are not truly identical and all facts are not equal. A broker-dealer would have a reasonable basis to believe that a higher cost is justified and nevertheless is in the retail customer's best interest if other differentiating factors are present, including, for example, as the Commission notes: "[t]he product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks and potential benefits, volatility and likely performance in a variety of market and economic conditions," in light of the retail customer's investment profile."<sup>14</sup> These factors, as well as the financial strength of the issuer, can weigh in favor of a more costly security or investment strategy over another alternative offered by the broker-dealer. The Commission should clarify that, in such a case, the lowest cost option is not required to be recommended in order to meet a Care Obligation and that the Care Obligation can be satisfied with disclosure of the differentiating factors as well as the relative costs.

## VII. **Reg BI: Conflict of Interest Obligation**

The Proposal states:

- (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 at a minimum disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.<sup>15</sup>

The Commission states that material conflicts of interest arising from financial incentives would include, but are not limited to:

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<sup>13</sup> Release No. 83062 at p. 149

<sup>14</sup> Release 83062 at p. 148.

<sup>15</sup> Release No. 83062 at p. 405; 17 CFR §240.15l-1(a)(2)(iii).

- “compensation practices established by the broker-dealer, including fees and other charges for the services provided and products sold”;
- “employee compensation or employment incentives (e.g., quota, bonuses, sales contests, special awards, differential or variable compensation, incentives tied to appraisals or performance reviews)”;
- “compensation practices involving third-parties, including both sales compensation and compensation that does not result from sales activity, such as compensation for services provided to third-parties (e.g., sub-accounting or administrative services provided to a mutual fund)”;
- “receipt of commissions or sales charges, or other fees or financial incentives, or differential or variable compensation, whether paid by the retail customer or a third party”;
- “sales of proprietary products or services, or products of affiliates”;
- “transactions that would be effected by the broker-dealer (or an affiliate thereof) in a principal capacity.”<sup>16</sup>

The Commission states, “In addition, we believe certain material conflicts of interest arising from financial incentives may be more difficult to mitigate, and may be more appropriately avoided in their entirety for retail customers or for certain categories of retail customers (e.g., less sophisticated retail customers),” and provides as an example, “the receipt or payment of certain non-cash compensation that presents conflicts of interest for broker-dealers, for example, sales contests, trips, prizes, and other similar bonuses that are based on sales of certain securities or accumulations of assets under management.”<sup>17</sup>

The Commission should also clarify that a material conflict of interest does not arise merely because a broker-dealer offers a limited menu of investments that may include proprietary investment options.

The release is unclear as to whether and how certain material conflicts of interest involving financial incentives can be effectively disclosed and mitigated or whether the Commission might, after the fact, view certain financial incentives as ones that should have been eliminated rather than disclosed and mitigated. Although the Commission provides some guidance about potential mitigation practices, we ask for confirmation that minimum production requirements that do not favor one product over another to maintain a contract of employment would not be considered a “quota” that had to be disclosed and mitigated or eliminated.

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<sup>16</sup> Release No. 83062 at p. 169.

<sup>17</sup> Release No. 83062 at p. 183.

#### VIII. **Reg BI: Recordkeeping**

The Proposal requires certain exchange members and broker-dealers, for each retail customer to whom a recommendation of any securities transaction or investment strategy involving securities is or will be provided, to make a record of all information collected from and provided to the retail customer pursuant to Reg BI, as well as the identity of each associated person, if any, responsible for the account and to preserve all account record information required pursuant to proposed Rule 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.<sup>18</sup>

The proposed rule is broader than current Rule 17a-3(a)(17) (natural person customer or owner account records) as it requires retention of the related and underlying communications that convey the retail customer investment profile information rather than a simple record of the information itself. Existing Rule 17a-4(b)(4) requires broker-dealers to keep “originals of communications received and copies of all communication sent (and any approvals thereof) by the member, broker or dealer (including inter-office memoranda and communications) relating to its business as such, including all communications which are subject to rules of a self-regulatory organization of which the member, broker or dealer is a member regarding communications with the public.” The new proposed rule seems unnecessary and inconsistent since the retention period for records to be maintained pursuant to Rule 17a-4(b)(4) is not less than three years, the first two years in an easily accessible place, rather than the six-year period stated in proposed Rule 17a-4(e)(5). If a new records rule is to be established, then more specificity is needed to make clear precisely what information is required to be maintained under Reg BI, rather than the general “all information” in proposed Rule 17a-3(a)(25).

#### IX. **Form CRS: Definition of Retail Investor**

The Proposal, 17 CFR §240.17a-14(e)(2), states:

*“Retail Investor”* means a customer or prospective customer who is a natural person (an individual). This term includes a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust.<sup>19</sup>

The obligation for a broker-dealer to deliver a Form CRS is broader than the proposed application of Reg BI, which would apply when a broker-dealer provides a recommendation. The

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<sup>18</sup> Release No. 83062 at pp. 406-407; 17 CFR §240.17a-3(a)(25) and 17 CFR §240.17a-4(e)(5).

<sup>19</sup> Exchange Act Release No. 83063 (Apr. 18, 2018) at p. 463, available at <https://www.sec.gov/rules/proposed/2018/34-83063.pdf>.

proposed definition includes all natural persons, regardless of the individual's net worth. As noted above, the definition of "retail investor" in Form CRS and "retail customer" in Reg BI should include only natural persons, or their legal representatives who are not professional fiduciaries, subject to net worth limitations, as described above in section IV, Reg BI: Definition of Retail Customer. The term "retail investor" for purposes of Form CRS also should not include retirement plan representatives.

More guidance is needed from the Commission as to firms' Form CRS obligations regarding "prospective customers" as it will be operationally difficult to track Form CRS deliveries to natural persons who do not become customers.

#### **x. Form CRS: Narrative and Graphical Format**

Form CRS is required to be delivered by investment advisers and broker-dealers to retail investors before or at the time the investment adviser enters into an investment advisory agreement with a retail investor or at the time the retail investor first engages the broker-dealer's services. Form CRS has a prescribed format in which content and presentation largely are prescribed.

As a threshold matter, we do not think that Form CRS is necessary for investment advisers to provide because it is largely duplicative of disclosures already required of investment advisers in Form ADV, Part 2.<sup>20</sup> The Commission requires fulsome and meaningful disclosure in Form ADV, which is required to describe an investment adviser's business, investment programs, fees, and material conflicts, among others. The use of a Form CRS may confuse retail investors as it cannot, by design, contain the very important disclosures required in Form ADV with enough detail and specificity adequately to inform a client about information material to the adviser's services, conflicts and fees. In other words, more disclosure is not necessarily better disclosure; it can simply be more, and overwhelm retail investors with too much of the same information.

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<sup>20</sup> As the Commission states on its website, <https://www.sec.gov/fast-answers/answersformadvhtm.html>:  
Beginning in 2011, Part 2 requires investment advisers to prepare narrative brochures written in plain English that contain information such as the types of advisory services offered, the adviser's fee schedule, disciplinary information, conflicts of interest, and the educational and business background of management and key advisory personnel of the adviser. The brochure is the primary disclosure document that investment advisers provide to their clients. When filed, the brochures are available to the public on the IAPD website.

Investment advisers are required to deliver annually to clients a summary of material changes to the brochure and either deliver a complete updated brochure or offer to provide the client with the updated brochure. In addition, an investment adviser must deliver to clients a brochure supplement that provides information about the specific employees, acting on behalf of the investment adviser, who actually provide the investment advice to the client. The brochure supplement also includes contact information for the person's supervisor in case the client has a concern about the person. The brochure supplement must be delivered either before or at the time that the employee begins to provide investment advice to a client. An updated supplement must be delivered to clients when there is new disclosure of a disciplinary event, or a material change to disciplinary information that has already been disclosed.

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Given the plain English, comprehensive disclosures already required of investment advisers, the better, less confusing course would be to amend the requirements of Form ADV, Part 2, to include information, if any, that the Commission concludes should be added to accomplish the objectives of Form CRS. Or, if the Commission wishes to reduce the type and nature of the investment advisory disclosure provided to clients, we recommend the Commission undertake to amend Form ADV. If the Commission does not accept that recommendation, then we ask the Commission to consider the following comments.

We agree that providing retail investors with important information to consider when choosing a firm and a financial professional is beneficial. However, if a Form CRS is to be required of both investment advisers and broker-dealers, the entities should have more discretion to tailor the content, page limit, and number of key questions to make the scope and presentation of information more meaningful to their respective retail investors.

We also ask the Commission to clarify the Conflicts of Interest section to state that only **material** conflicts of interest, as defined above, are to be included.

While the release states that broker-dealers and investment advisers will be required to include cross-references to where retail investors could find additional information, such as in the Form ADV Part 2 brochure and brochure supplement for investment advisers, or on the firm's website or in the account opening agreement for broker-dealers, more clarity is needed as to what would be sufficient by way of cross-references and links to satisfy this requirement.

The instructions to Form CRS state, "You must deliver the relationship summary even if your agreement with the retail investor is oral."<sup>21</sup> It is unclear what constitutes an "oral agreement" that would trigger Form CRS delivery requirements and more guidance from the Commission is needed to clarify this requirement.

The release states, "If a prescribed statement is not applicable to the firm's business or would be misleading to a reasonable retail investor, the firm would be permitted to omit or modify that statement."<sup>22</sup> There is a concern that the Commission later could find a violation of Form CRS because of such omissions or modifications. The Commission should allow more flexibility in the prescribed words and allow more open-ended narrative, so that firms can better capture the range of business models among investment advisers and broker-dealers. Since firms must file Form CRS with the Commission, the Commission would have an opportunity to review and notify an investment adviser or broker-dealer that its Form CRS is noncompliant.

It will be difficult to operationalize answers to the key questions. For example, it is not feasible to expect, at the early stage of engaging with a prospective or existing investor who has

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<sup>21</sup> <https://www.sec.gov/rules/proposed/2018/34-83063-appendix-b.pdf> at p. iii.

<sup>22</sup> Release No. 83063 at p. 36.

not yet made an investment decision, that a financial professional would be able to respond to the request to, “Do the math for me,” requiring him or her to put together personalized fee information and estimates during the account opening process. Broker-dealers and investment advisers would have to implement new recordkeeping policies and procedures, including compliance and supervision reviews, to address communications between financial professionals and retail investors about how the key questions should be answered. In lieu of prescribing one size fits all “Key Questions to Ask,” the Commission should provide general educational information on its own website, covering the subject matter of the key questions, and encouraging retail investors to ask questions of their broker-dealers or investment advisers.

The release states:

Finally, broker-dealers would be required to include the following if they significantly limit the types of investments available to retail investors in any accounts: “We offer a limited selection of investments. Other firms could offer a wider range of choices, some of which might have lower costs.” A broker-dealer would significantly limit the types of investments if, for example, the firm only offers one type of asset (e.g., mutual funds, exchange-traded funds, or variable annuities”), the firm only offers mutual funds or other investments sponsored or managed by the firm or its affiliate (i.e., proprietary products), or the firm only offers a small choice of investments. In addition, if the limitations only apply to some of the accounts the firm offers, such as, for example, limiting the types of investments for retail investors within different asset tiers, then the firm would have to identify those accounts.

Limitations on investments offered could have a significant effect on investor choice and performance of the account over time. In particular, firms that offer proprietary products exclusively preclude investor access to competing products that could offer lower fees or result in better performance over time. As a result, retail investors should understand these limitations before they enter into a relationship with a firm.<sup>23</sup>

It is unclear what “significantly limits” means for firms that offer predominantly, but not exclusively, proprietary products. It is also unclear what constitutes a “small choice of investments.” Additional examples or more prescriptive instructions regarding when firms must disclose such limitations would be helpful. The issue is particularly significant for broker-dealer affiliates of insurance companies. An insurance producer, who also is a registered representative of an affiliated broker-dealer, may offer the variable life insurance policies or variable annuity contracts of more than one insurer and may limit the range of policies or contracts recommended to retail investors based on a captive or affiliation agreement with a particular insurer. The Commission should confirm that such conduct would not be in violation of Form CRS, provided

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<sup>23</sup> Release No. 83063 at pp. 39-40.

that the producer prominently discloses to each retail investor, in writing, before or at the time the retail investor first engages the broker-dealer's services, the nature of the agreement and the circumstances under which the producer typically will and will not limit the recommendations.

For example, without limitation, these circumstances may include where a producer primarily recommends variable life insurance policies or variable annuity contracts of a particular insurer and secondarily recommends policies or contracts from one or more other insurers when: (1) the primary insurer does not offer a policy that meets the retail investor's needs or objectives, (2) the type of policy or contract in the best interest of the retail investor is not available from the primary insurer, (3) the underwriting criteria of the primary insurer are not favorable for the retail investor, or (4) the offer made by the primary insurer is not acceptable to the retail investor. The Commission should confirm that a producer who adheres to the conditions in the disclosure with each retail investor, except when the producer reasonably determines that it is in the best interest of the retail investor not to do so, would be in compliance with Form CRS. We acknowledge that the disclosure would be insufficient if it merely states that the producer may limit recommendations without specific disclosure of the extent to which recommendations are, in fact, limited.

#### **XI. Form CRS: Filing**

Dual registrants are required to give a Form CRS to retail investor clients or customers of both its advisory and brokerage businesses and file Form CRS on both IARD and EDGAR. The duplicate filing requirement seems redundant when the dual registrant's Form CRS makes it obvious that the filer is a dual registrant. The Commission should clarify that a single filing, in either IARD or EDGAR, would constitute compliance with the filing requirement.

#### **XII. Form CRS: Updating**

Form CRS must be updated within thirty days whenever any information in it becomes "materially inaccurate." The changes must be communicated to retail investors who are existing clients or customers of the firm within thirty days after the updates are required to be made and without charge. The communication can be made by delivering the amended Form CRS or by communicating the information "in another way" to the retail investor. We ask that the Commission confirm that the same principles for making updates when information becomes materially inaccurate for Form ADV or prospectuses would apply to updating Form CRS and that firms can draw from prior guidance and practice in those areas.

A Form CRS must be delivered to existing clients and customers before or at the time: (1) a new account is opened that is different from the retail investor's existing account(s); or (2) changes are made to the retail investor's existing account(s) that would materially change the nature and scope of the relationship with the retail investor. Whether a change would require

delivery of the Form CRS would depend on the specific facts and circumstances. Again, more guidance is needed on this point; additional examples of triggering events would provide clarity.

### **XIII. Interpretation of Investment Advisers' Existing Fiduciary Obligations**

The Commission voted to propose interpretative guidance on the standard of conduct for investment advisers under the Investment Advisers Act of 1940 (Advisers Act) (“Interpretation”) rather than adopt a uniform standard of conduct that would apply equally to investment advisers and broker-dealers when providing advice to retail investors. The Commission’s approach rightfully recognizes the differences in the types of relationships that broker-dealers and investment advisers have with their clients and different models for providing advice. The proposed Interpretation seeks to “reaffirm” and “clarify”<sup>24</sup> certain aspects of the fiduciary duty an investment adviser owes to its clients.

While much of the proposed Interpretation consists of citations of well-settled principles, the Commission advanced its current thinking on the fiduciary duty of investment advisers in significant ways, departing from the historic understanding of that duty in a manner that introduces confusion and doubt as to the ongoing applicability of longstanding interpretations of an investment adviser’s fiduciary duty under Section 206(1) and (2) of the Advisers Act. Rather than strengthen the understood protections afforded by an investment adviser’s fiduciary duty to a client, as discussed below, the Interpretation introduces doubt and uncertainty, which could limit investment opportunities of investors.

#### *Historic Understanding of Fiduciary Duty*

As noted in the Interpretation, an adviser’s fiduciary duty “follows the contours of the relationship between the adviser and its client, and the adviser and its client may shape that relationship through contract when the client receives full and fair disclosure and provides informed consent.”<sup>25</sup> The Commission acknowledges that there is an ability to “tailor the terms” of the fiduciary duty, which will vary with the terms of the relationship. The Commission quotes established precedent that an adviser may violate its fiduciary duty and the anti-fraud provisions of the Investment Advisers Act of 1940 if it does not, at a minimum, provide full and fair disclosure of the conflict and its impact on the client and obtain informed consent of the conflict. The Commission acknowledges that a client’s informed consent can be either explicit or, depending on the facts and circumstances, implicit. The restatement above comports with the historic understanding of an investment adviser’s fiduciary duty and a client’s ability to fashion terms closer to his or her needs or seek an investment adviser providing terms in keeping with the client’s needs and objectives.

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<sup>24</sup> Release No. 4889 at p. 5.

<sup>25</sup> Release No. 4889 at p. 8.

### *Ability to Tailor Contractual Responsibilities*

The proposed Interpretation reinforces the well-understood concept that an adviser's obligations will vary among clients based on the contours of a particular advisory relationship and as agreed upon with the client by contract. The Commission also states that "the relationship in all cases remains that of a fiduciary to a client" and states that an adviser "cannot disclose or negotiate away, and the investor cannot waive, the federal fiduciary duty."<sup>26</sup> While we do not believe an adviser can waive their fundamental responsibility to clients of loyalty and care in providing suitable advice, we would ask the Commission to confirm an adviser may contract for variances in the boundaries of their responsibility (services, security types to consider, accounts to monitor, among others) and that such variance is not a "waiver" of fiduciary duty within the terms of the Commission's statement.

The ability to "tailor the terms" of the advisory relationship provides clients with greater choice because advisers are free to offer customized and differentiated advisory products and services at different price points. For example, a client can seek comprehensive advice including tax, insurance, estate planning, and investment recommendations, or can seek narrow, more limited goals-based advice on a particular account (such as a "robo"), and not advice on the client's broader financial picture. This choice made by the client effectively narrows the scope of services to only such advice and services as the client chooses to receive (and pay for), but does so without eliminating the adviser's fiduciary duty to the client. This ability of the client to narrow the scope of the relationship allows the client to choose a different provider or advice program to meet his or her comprehensive or simplified needs. For this reason, it would be helpful to clarify that the Commission is not stating that there is a "floor" on the terms of an advisory relationship, such that a client would no longer be able to consent to and receive narrower advisory services.

### *Conflict Disclosure and Informed Consent*

In a noteworthy departure from established precedent, the Commission states that "[d]isclosure of a conflict alone is not always sufficient to satisfy the adviser's duty of loyalty and section 206 of the Advisers Act."<sup>27</sup> The accompanying discussion also focuses on the quality of disclosure and whether it was understood by an investor (both subjective measures) and not whether an adviser can act if the conflict is disclosed and consented to. The Commission's Interpretation introduces doubt as to whether an investment adviser could ever effectively evidence the client's "understanding" of and consent to a conflict.

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<sup>26</sup> Release No. 4889 at p. 8.

<sup>27</sup> Release No. 4889 at p. 17.

Specifically, the Commission states that an adviser cannot infer consent if the facts and circumstances indicate that the client did not understand the nature and import of the conflict (*i.e.*, the sophistication of the client matters).<sup>28</sup> This position introduces doubt as to whether consent may be deemed, in hindsight, not to have been given because the conflict disclosure was not “understood” by the client. It is not clear how an adviser could evidence a client’s “understanding” of a conflict to the satisfaction of this new standard or what facts or circumstances signal red flags to a lack of understanding (absent a client’s obvious lack of or diminished mental capacity, such as of a vulnerable adult). For this reason, we ask the Commission to confirm that on evidence of disclosure provided and using a reasonable person test, the adviser can presume that the client has understood the disclosure (including in Form ADV, the client agreement or other point-of-sale disclosure documents).

The Commission also notes, without further discussion, explanation or examples, that there may be circumstances with some complex or extensive conflicts where it may be difficult to provide disclosure that is sufficiently specific, but also understandable to clients. This position introduces doubt as to whether a conflict may be deemed, in hindsight, to have been too complex or extensive (by what standard and in whose judgment) to have been consented to at all. It would be preferable for the Commission to delineate, with examples, which types of conflicts are too complex or extensive so that consent by an investor would be unavailing. It is not clear whether the Commission is stating that certain conflicts constitute a *per se* breach of fiduciary duty and must be eliminated, as they cannot be consented to.

#### *Retail v. Institutional Investors*

If the Commission adopts a form of the Interpretation, we recommend refocusing the Interpretation to the provision of advice to retail investors, as is the focus of Reg BI. As proposed, the Interpretation would apply to all investment advisers, including those providing advice to institutional investors and pooled investment vehicles such as mutual funds and private funds, and does not differentiate between advice provided to retail and institutional clients. An institutional client’s ability to negotiate different terms, including prices, services and duties, and understand and consent to conflicts, is markedly different from that of a retail investor. A restatement of fiduciary duty as in the Interpretation, which posits insurmountable conflicts, binds the hands of institutional and sophisticated parties who are in the best position to make determinations about what is in their own best interests, take business risks, define business terms, and determine for themselves which conflicts to accept. We are not, of course, advocating for the ability to negotiate away the fiduciary duty, but, rather, the flexibility of our institutional clients to shape it according to their own requirements.

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<sup>28</sup> Although, as noted below, the Interpretation does not distinguish between sophisticated and unsophisticated (or retail) investors.

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**XIV. Conclusion**

We look forward to working with the Commission to ensure that consumers have access to the products and services they need, under the model—commission-based or fee-based—they prefer. Should you have any questions concerning any of the matters discussed here, please contact Mary Jo Reich, Vice President, Corporate Counsel, at [mary.reich@Prudential.com](mailto:mary.reich@Prudential.com) or 973-367-3507.

Sincerely yours,



Ann M. Kappler

Copies to:

The Honorable Walter J. Clayton, Chairman  
The Honorable Kara M. Stein, Commissioner  
The Honorable Robert J. Jackson Jr., Commissioner  
The Honorable Hester M. Peirce, Commissioner  
Dalia Blass, Director, Division of Investment Management  
Brett Redfearn, Director, Division of Trading and Markets