



August 6, 2018

The Honorable Jay Clayton  
Chairman  
U.S Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**Re: Regulation Best Interest Standard [Docket Number 2018-08582];  
Form CRS Relationship Summary Amendments to Form ADV; Required Disclosures in  
Retail Communications and Restrictions on the Use of Certain Names or Titles [Document  
Number 2018-08583];  
Proposed Commission Interpretation Regarding Standard of Conduct for Investment  
Advisers; Request for Comment on Enhancing Investment Adviser Regulation [Document  
Number 2018-08679].**

Dear Chairman Clayton:

The American Association for Justice (AAJ), formerly the Association of Trial Lawyers of America (ATLA), hereby submits its response to the Security and Exchange Commission's (SEC or the Commission) May 9, 2018 proposed rules regarding:

- Establishing a best interest standard for broker-dealers and associated persons;<sup>1</sup>
- Mandatory disclosures in communications between retail investors and customers;<sup>2</sup> and
- The required standards of conduct for investment advisers and broker-dealers.<sup>3</sup>

AAJ, with members in the United States, Canada, and abroad, is the world's largest trial bar. It was established in 1946 to safeguard victims' rights and strengthen the civil justice system. AAJ members represent victims of fraud and other abuses that occur in the financial services market. In that capacity, we comment on the standards of conduct applicable to broker-dealers and registered investment advisers.

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<sup>1</sup> Securities and Exchange Commission: Regulation Best Interest (May 9, 2018) *available at* <https://www.federalregister.gov/documents/2018/05/09/2018-08582/regulation-best-interest>

<sup>2</sup> Securities and Exchange Commission: Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles (May 9, 2018) *available at* <https://www.federalregister.gov/documents/2018/05/09/2018-08583/form-crs-relationship-summary-amendments-to-form-adv-required-disclosures-in-retail-communications>

<sup>3</sup> Securities and Exchange Commission: Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation (May 9, 2018) *available at* <https://www.federalregister.gov/documents/2018/05/09/2018-08679/proposed-commission-interpretation-regarding-standard-of-conduct-for-investment-advisers-request-for>

In the best interest standard rule, the SEC seeks to establish an objective standard of conduct for broker-dealers and associated persons<sup>4</sup> (further referenced as broker-dealers) when making a recommendation of any transaction or investment strategy involving securities to a retail customer. The proposed standard purports to require a broker-dealer, when making a recommendation, to act in the best interest of the retail customer at the time the recommendation is made without placing the financial interest of the broker-dealer ahead of the interest of the retail customer.

For too long, American investors have received faulty investment advice that may not be in their best interest. Most individuals mistakenly assume that professional investment advice is provided without ulterior motives. Strong regulations that create a heightened scrutiny on the conduct of broker-dealers and protect the rights of investors will promote confidence in the fundamental fairness of America's financial system.

However, AAJ remains concerned with the language as drafted. The SEC's best interest standard fails in establishing a clear and cogent standard of conflict for broker-dealers, creating ambiguities and weaknesses in the rule, leading to more problems than solutions. These issues combine with the fact that the new regulation contains serious limitations in acceptable private judicial recourse. We provide our comments below.

**I. The SEC's proposal is not in the best interest of retail customers because it adopts a weak ambiguous standard without removing conflicts of interest.**

The SEC's best interest standard does not sufficiently address the conflicts of interest that too often influence broker-dealers' recommendations. Somewhat ironically, the SEC does not ever define what is its best interest standard. Relying instead on a "know it when I see it approach," broker-dealers are expected to use suitable investment standards without actual knowledge of what that entails. This confusion will only lead to investment advice that is *not* in the best interest of a retail customer.

The material disclosure requirements are inadequate in providing investment customers with any protections from conflicts of interest. Ample studies show that customers do not spend time reading boilerplate disclosures, making these provisions ineffective in educating clients on the complex nature of the investment relationship. Only through adequate verbal *and* written explanation of the roles and duties between a broker-dealer and a customer will material conflicts be reduced.

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<sup>4</sup> Defined as any partner, officer, director or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of section 15(b) of this title (other than paragraph 6 thereof).

Finally, the best interest standard applies to each individual broker-dealer recommendation separately, without considering the whole scope of the relationship between the broker-dealer, the client, and other relevant factors that are germane to establishing a duty of care and to prevent material conflicts. Many retail customers have long-standing relationships with their broker-dealers. Under the SEC's proposed rule, a continuing relationship between a broker-dealer will be held to the same standard as one making their first recommendation. Instead, the SEC should adopt a totality of the circumstances approach that looks at relevant evidence of a continued relationship between a broker-dealer and a retail customer for shaping a heightened duty of care and prudence.

For these reasons, AAJ cannot support this standard. Simply put, the Commission's best interest standard is confusing and inadequate, leaving its purpose of eliminating material conflicts of interest doubtful.

## **II. A private cause of action is essential in enforcing increased standards for broker-dealers.**

The SEC's proposed rule is currently ambiguous as to how its standard will be enforced. AAJ specifically notes that failure to include appropriate enforcement mechanisms for the rule, such as a private right of action, will significantly limit its impact. Without a mechanism for accountability, any conflict of interest standard will not be effective for investors.

In the proposal the SEC states:

[W]e are not proposing to amend or eliminate existing broker-dealer obligations, and compliance with Regulation Best Interest would not alter a broker-dealer's obligations under the general antifraud provisions of the federal securities laws. Regulation Best Interest applies in addition to any obligations under the Exchange Act, along with any rules the Commission may adopt thereunder, and any other applicable provisions of the federal securities laws and related rules and regulations. Furthermore, *we do not believe proposed Regulation Best Interest would create any new private right of action or right of rescission, nor do we intend such a result.*

(emphasis added). The U.S. Supreme Court has long acknowledged the vital importance of private securities litigation as a "most effective weapon" in the federal enforcement regime<sup>5</sup>, and has recognized a further private right of action to enforce SEC Rule 10b-5 actions.<sup>6</sup> Furthermore, Congress permits private causes of action under the Securities and Exchange Act.<sup>7</sup> Private actions are currently brought through class action lawsuits to enforce a common nucleus of misconduct centered around fraud, material misstatements/omissions, or purposely deceiving practices. The SEC proposed rule will create a duty of care standard for broker-dealers when making recommendations. However, enforcement of this new standard will not rely on the most

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<sup>5</sup> See *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985)

<sup>6</sup> See 17 C.F.R. § 240.10-b-5; *Superintendent of Ins. of N. Y. v. Bankers Life & Casualty Co.*, 404 U. S. 6, 13, n. 9 (1971)

<sup>7</sup> 15 U.S.C. § 77z-1

effective enforcement methods. The SEC will instead depend on its own internal enforcement methods, which will result in retail customers' inability to seek recourse against inappropriate broker-dealer conduct.

By choosing to limit a private cause of action, the SEC will be unable to fully enforce its new additional standard of care for broker-dealers because of the Commission's lack of adequate resources and time. In its FY17 Agency Financial Report, the SEC stated that it processed 446 cases during the year with an overall enforcement budget of \$8.12 million.<sup>8</sup> The SEC could not guarantee that all claims could be addressed, stating it would only "direct its limited resources toward cases that are likely to have the greatest impact in furthering the SEC's mission."<sup>9</sup> It also identified that despite its enforcement costs increasing \$2 million from FY16 to FY17, its budget was reduced to \$5.2 million in FY17.<sup>10</sup> Implementing an additional best interest standard for enforcement, combined with stated limited resources, and the inability for the Commission to process all its claims, a private cause of action is the most economically efficient and practical mechanism for injured consumers to hold bad actors accountable within the framework of the market for financial services. Only through total enforcement will broker-dealers be truly held accountable for their misconduct.

Access to the full protections of the Seventh Amendment and our judicial system is a staple of constitutional democracy and a functioning market economy. When one party harms another in a transaction, the most efficient way to right that wrong without unjustly enriching one member of the transaction is through the civil justice system—a fact that the Commission has repeatedly acknowledged in its reliance on the mechanism of the private class action in resolving disputes under the securities laws.<sup>11</sup>

### **III. Conclusion: A private cause of action is necessary for investor industry accountability.**

Strong accountability standards are paramount in creating commonsense broker-dealer policies. By not applying a private cause of action and prohibiting access to our judicial system, the SEC will fail to achieve its stated purpose of protecting investment customers from actual harm resulting from broker-dealer conduct. The public must be informed and deserves full transparency when choosing whom to trust for investment needs. Further, it is only through public accountability that systemic problems come to light and can be addressed.

AAJ encourages the Commission to strengthen the conflict of interest standard and to include a private cause of action for harmed investors under this standard. If you have any questions or

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<sup>8</sup> Securities and Exchange Commission: Agency Financial Report, Fiscal Year 2017 (November 13, 2017) available at <https://www.sec.gov/files/sec-2017-agency-financial-report.pdf>

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> 15 U.S.C. § 78u-4 ("Private securities litigation"). *See also* Securities and Exchange Commission, "How can investors get money back in a fraud case involving a violation of the federal securities laws?" (referencing, in particular "private class actions") available at <https://www.sec.gov/fast-answers/answersrecoverfundshmtm.html>.

comments, please contact Sarah Rooney, Senior Director of Regulatory Affairs at (202) 944-2805, or Brian McMillan, Federal Relations Counsel at [REDACTED].

Sincerely,



Elise Sanguinetti  
President  
American Association for Justice