



VIA ELECTRONIC MAIL

August 7, 2018

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Regulation Best Interest-Request for Comment

Dear Secretary Fields:

Sorrento Pacific Financial, LLC (SPF) appreciates the opportunity to comment on this important proposal. SPF has long supported a best interest standard of care that is applicable to all professionals providing personalized investment advice to retail clients and enforced by the SEC as the appropriate jurisdictional agency. We largely support the Proposed Rulemaking Package and offer feedback and suggestions below.

I. Overview

While Proposed Regulation Best Interest clearly extends to broker-dealers a duty to act in the customer's best interest, the Commission has properly adopted a principles-based standard allowing firms to tailor their practices to their business model and clients. Broker-dealers would demonstrate compliance with this duty by: 1) disclosing key facts about the customer relationship, including material conflicts of interest; 2) exercising reasonable diligence, care, skill and prudence to understand the product and have a reasonable basis to believe that product is in the customer's best interest; and 3) establishing and enforcing policies and procedures reasonably designed to identify, disclose, and mitigate or eliminate conflicts of interest arising from financial incentives. We applaud the SEC for acknowledging that conflicts will inevitably exist, but must be managed appropriately.

II. Best Interest Standard of Care

A. Introduction

We strongly support the Proposed Rulemaking Package's clearly defined best interest standard of care for broker-dealers, which draws on an investment adviser's duties of care and loyalty. SPF commends the SEC for recognizing the unique characteristics of the broker-dealer model and choosing to build upon the already extensive regulatory regime in that space, rather than simply imposing a new standard. We offer further supportive feedback below.



B. Clearly Defined Duty to Act in the Best Interest of a Retail Customer

Proposed Regulation Best Interest requires that when making a recommendation to a retail customer, a broker-dealer has a duty to act in the best interest of the retail customer at the time a recommendation is made, without putting the financial or other interest of the broker-dealer ahead of the retail customer. This clearly requires a broker-dealer to put the needs of the customer first. Articulating the standard in this way correctly recognizes that a broker-dealer's financial interest can and will inevitably exist, but that interest cannot be the predominant motivating factor. A best interest standard does not require broker-dealers to maintain a conflict-free culture, but rather that conflicts be adequately addressed. Thus, a best interest standard must be designed to appropriately address conflicts of interest because they may arise in any relationship where a duty of care or trust exists between two or more parties. Being completely "conflict free" is not possible for financial professionals,

C. Different Standards Based on Uniform Principles

Some commenters have expressed concern that the Proposed Rulemaking Package does not impose a uniform fiduciary standard of care on both broker-dealers and investment advisers. However, the SEC correctly approached this rulemaking effort with the goals of providing clear, understandable, and consistent standards for recommendations across a brokerage relationship; better aligning this standard with other advice relationships; and preserving investor choice and access to existing products, services, service providers and payment options. This last goal is so essential to SPF and their clients – they must retain their ability to choose both the relationships with their financial professional and the products and investment vehicles they wish to utilize to meet their financial goals.

Research shows that investors who work with financial professionals save more, are better prepared for their retirement, and have greater confidence in their retirement planning. Rather than imposing the exact same standards on different business models, the Proposed Rulemaking Package draws from key principles underlying the fiduciary obligations that apply to investment advice in other contexts. Because their business models are different, it is appropriate to have different standards for investment advisers and broker-dealers and their representatives provided they are based on a uniform set of principles. As Chair Clayton observed, "while the two standards draw from common principles, some obligations of broker-dealers and investment advisers will differ because the relationship types of these investment professionals differ. This is a practical necessity. But the principles are the same....". SPF commends the SEC for recognizing the unique characteristics of the broker-dealer model and choosing to build upon the already extensive regulatory regime in that space.

Further, the client relationships have different characteristics under each business model. A brokerage relationship is transaction based, a broker-dealer may provide a variety of services some of which may include advice, and they may be acting in a principal or agent capacity. An advisory relationship, as its name implies, revolves around the provision of advice related to investments, which may include portfolio management on a discretionary basis. Some industry stakeholders object to the fact that broker-dealers have an episodic duty of care, whereas investment advisers have an ongoing duty of care. Not only does the proposed best interest obligation for broker-dealers reflect the



fundamental difference in the relationship, but §913 of Dodd Frank instructed the Commission to consider establishing a standard of conduct for broker-dealers and investment advisers “when providing personalized investment advice about securities to retail customers.” Based on their needs and preferences, retail clients can choose whether to work with a broker-dealer or an investment adviser, including negotiating the frequency of account monitoring. Further, as the client’s needs change, they have the flexibility to change how they work with their financial professional. Maintaining the differences in business models is essential to preserving investor choice and access to a range of products and services.

D. Disclosure Obligation

SPF agree that a best interest standard of care should require reasonable and streamlined disclosures to ensure industry participants effectively communicate their conflicts of interest to their clients and potential clients. The Proposed Rulemaking Package would require broker-dealers to disclose to their retail customers key facts related to the scope and terms of their relationship, including material conflicts of interest. Material facts relating to the scope and terms of the relationship include: that the broker-dealer is acting in a broker-dealer capacity with respect to the recommendation; the fees and charges that apply; and the type and scope of services provided. A material conflict of interest is one that a reasonable person would expect might incline a broker-dealer to make a recommendation that is not disinterested. However, the Proposed Rulemaking Package does not require broker-dealers and their registered representatives to be conflict free, nor would it *per se* prohibit or allow certain transactions involving conflicts such as transaction based compensation or proprietary products. This is critical to ensuring investor access to advice, products and services. We support the SEC’s principles-based approach to the form, timing and method of this disclosure obligation and agree that the format should be “concise, clear, and readable.” Broker-dealers’ and investment advisers’ disclosure obligations should address material conflicts of interest arising in a firm’s specific business model.

We offer comments on the requirements of the proposed Form CRS in a subsequent section and support the SEC’s layered approach to these disclosures. However, more disclosure does not result in better disclosure. Because the two broker-dealer disclosure requirements serve similar purposes and may provide duplicative information, we suggest that providing the Form CRS be deemed to satisfy the broker-dealer’s Disclosure Obligation under Regulation Best Interest.

SPF has long advocated a two-tier client disclosure that starts with a concise point-of-sale document at the time of formal engagement between the advisor and the investor. This initial disclosure would reference more detailed disclosures posted to the firm’s website or otherwise made available to the investor in a format or formats they prefer. As we discuss below, we believe the CRS matches many of the aspects of such a disclosure, but we also urge the SEC not to underestimate the value investors place on their relationship with their financial professional. The greatest benefit of these disclosures will come in the conversations they facilitate between the client and their financial professionals.

E. Conflicts of Interest



Just as no rulemaking should be expected to eliminate all conflicts which are inherent and unavoidable, no proposal can address conflicts through excessive and duplicative disclosures alone. Experience shows that investors already ignore much of the enormous volume of regulatory disclosures they are being provided. Instead, a more realistic approach is to require broker-dealers to adopt written supervisory procedures to detect and manage conflicts of interest, to avoid those they can and take steps to mitigate the impact of those conflicts that can't be avoided.

The SEC designed the Proposed Rulemaking Package to reduce retail investor confusion while preserving the unique structure and characteristics of the broker-dealer customer relationship and building upon existing regulatory obligations by drawing on the principles of the obligations that apply to investment advice in other contexts. Specifically, it would not *per se* prohibit a broker-dealer from transactions involving conflicts of interest, including for example: receiving commissions or transaction based compensation, but would require such material conflicts to be reasonably disclosed. We agree with the SEC that not all conflicts are *per se* good or bad, but must be appropriately managed.

Some have expressed concern that the Proposed Regulation Best Interest does not require broker-dealers to eliminate or mitigate conflicts, merely to have policies and procedures in place. However, we contend that this principles-based approach will lead firms to eliminate conflicts that cannot be managed. We saw a similar outcome in response to the Department of Labor's Fiduciary Rule, when many firms leveled compensation within product categories. Others argue that mitigation does not go far enough. Commissioner Jackson observed that, "many of the most harmful conflicts are created by firms themselves through practices like sales contests, quotas, and bonuses for selling proprietary products." However, the Proposed Regulation Best Interest clearly states that it would be inconsistent with its Care Obligation to make a recommendation solely to satisfy firm sales quotas, or to win a firm-sponsored sales contest. Further, the vast majority of firms have eliminated old-style sales contests contemplated by Commissioner Jackson. Rather, firms have adopted the use of incentives such as annual reward trips with a business component based on a product agnostic goal, which do not have the same conflicts as old-style sales contests. We would ask the final rule to clarify that subject to the Care and Disclosure Obligations, product agnostic incentives such as these are permissible.

F. Key Terms

We suggest that the final rule codify the term "recommendation" in accordance with the FINRA guidance and case law referenced in the Proposed Rulemaking Package. This guidance defines a recommendation based on whether it is a call to action to engage in a specific investment or investment strategy, expressly including situations where no specific personalized advice is given. FINRA Rule 2111 sets forth an explicit standard for what constitutes a recommendation and recognizes "call to action" as the hallmark. This concept is fully understood and in use by the industry, so there is no need to create a new standard..

III. Form CRS Relationship Summary



SPF supports a layered approach to disclosure, providing key information up front in a concise, easy to read format, which offers links or direction to more detailed and current disclosures on the company's website. We agree that brief disclosure is more effective than a long-form narrative and support requiring the use of "plain-language" principles in the relationship summary. However, SPF is concerned that some of the prescribed disclosure language is highly problematic, will add to investor confusion, and would negatively impact their client relationships. Further, we request clarity on particular points outlined below.

The Proposed Rulemaking Package would require broker-dealers to make two, potentially duplicative, disclosures: the Disclosure Obligation required by Proposed Regulation Best Interest; and the Form CRS Relationship Summary. Registered Investment Advisers would only be required to provide the Form CRS. These disclosure obligations would supplement rather than replace existing disclosure requirements and are intended to clarify the capacity in which a firm or financial professional is acting through a layered approach to disclosure. In order to provide broker-dealers greater flexibility, the SEC did not specify the form, manner, or frequency of the Disclosure Obligation. In contrast, the majority of the content and form of Form CRS is dictated in order to standardize disclosures across firms and business models. While both provisions are well intended, having two such disclosure requirements – one of which gives the firm broad discretion, the other very little discretion- will likely result in investor confusion and confusion for firms as to whether their obligations have been met. Further, broker-dealers are already subject to requirements that add another layer of protection for investors, including: periodic examinations, advertising review, and continuing education requirements. These requirements do not apply to investment advisers. Because the two broker-dealer disclosure requirements serve similar purposes and may provide duplicative information, we suggest that providing the Form CRS be deemed to satisfy the broker-dealer's Disclosure Obligation under Proposed Regulation Best Interest.

Registered investment advisers and broker-dealers would be required to provide the Form CRS relationship summary to retail investors at the establishment of a relationship, and to provide updates to retail investors following a material change. Requiring disclosures at the point of each transaction is unworkable and would not provide usable information to the client. Or, as stated previously, more disclosure does not necessarily result in better disclosure. The proposed conflicts disclosure can be made once and then updated if there are substantive changes, rather than every time the client makes a transaction, which is less burdensome for financial professionals and more effective for investors. While the Proposed Form CRS is clear that delivery of an updated Form CRS would only be required if there is a material change in the nature of the firm's relationship with an investor, the determination of whether a change is material "would depend on specific facts and circumstances." To reduce potential confusion for firms and their financial professionals, we suggest that the SEC provide further guidance on what specific facts and circumstances would trigger delivery of a new CRS. And to minimize investor confusion, keep in mind that the longer the disclosures, the less likely it is that they will be read.

While we support the Commission's efforts to ensure concise disclosure by limiting the required Form CRS to four pages (or its electronic equivalent), we suggest an even shorter document (perhaps as short as one page) with hyperlinks to more detailed disclosures. This approach benefits consumers by allowing them to click through to more information on specific points of concern to them; and it



benefits firms by allowing them to keep these disclosures up-to-date in the most cost-effective way possible. Financial professionals can point their clients to one centralized location that will always have the most accurate information. This one-page-with-hyperlinks model also facilitates the delivery of an updated Form CRS in the event of a material change.

In addition to requiring delivery of the Form CRS, the Proposed Rulemaking Package specifies the bulk of its content and presentation in the form's instructions, allowing firms limited discretion in the scope and presentation of firm-specific information. For some items, firms would have flexibility in how they provide required information; for others, firms are required to use prescribed wording and/or formats. While we appreciate the SEC's intent to facilitate comparisons across firms, some of the prescribed language may result in unintended investor confusion and undermine the relationship between investors and their financial professionals.

We are concerned about the statement that "our interests can conflict with your interests." Though investors surely take into account the cost of products and the fees they pay, and they certainly expect their financial professional to make recommendations in their interest, they also highly value the relationship they have with the financial professional. Most of SPF's financial professionals live and work in the same communities as their clients. The financial professional's relationships with these clients rest on their good reputation for doing honest, fair business with other members of the community. This type of relationship is impossible to summarize the way you can summarize legal duties and product fees. Chairman Clayton has said that he sees Form CRS as the starting point for a conversation between investors and their financial professionals. Such a conversation is made more confusing by requiring statements such as those that would undermine or negatively impact the client relationship.

The Proposed Form CRS also uses ongoing monitoring as the demarcation between investment advisers and broker-dealers. In practice, this is not necessarily accurate, which makes requiring the statement "unless we agree otherwise, we are not required to monitor your portfolio or investments on an ongoing basis" highly problematic. If indeed the Proposed Form CRS is part of a larger conversation between the financial professional and retail investor, the extent and frequency of monitoring would already be made clear and this required language could result in investor confusion.

SPF supports a two-tiered approach to disclosure, the initial piece of which would serve to provide investors with the information that is most critical to their decision-making at the point in time when that information is most useful, can be delivered most efficiently, and provides the investor the opportunity to ask additional questions. We believe the Proposed Form CRS matches many of the aspects of this regime, but we urge the SEC not to underestimate the value investors place on their relationship with their investment professional. The greatest benefit of the CRS will come in the conversations it facilitates between the client and their investment professional.

IV. Restrictions on the use of Certain Names or Titles

The Proposed Rulemaking Package would restrict the use of the terms "adviser" or "advisor" to registered investment advisers and their supervised persons providing investment advice on their



behalf. We wholeheartedly support the SEC's intended purpose of ensuring that retail investors understand the standard of care owed to them by their financial professional. However, we are concerned that restricting the use of certain titles may lead bad actors to simply adopt other similarly misleading titles rather than solving the problem. Most of our financial professionals are dual registrants. We agree that it does not make sense to base title restrictions on the type of product offered, but rather they should be based on disclosure, which will ensure that the investor understands the capacity in which they are working with the financial professional.

A common business model in the IBD industry is for a firm's registered broker-dealer and registered investment adviser to be affiliates rather than one firm that is dually registered. In such a case, some but not all, of their associated financial professionals will be dually registered. The Proposed Rulemaking Package does not indicate whether or under what circumstances financial professionals associated with firms who have a broker-dealer firm and a registered investment adviser firm who are affiliated could use "adviser" or "advisor" in its name or title when communicating with retail investors. Because this is a common business model, we suggest that the final rule specify that firms that are affiliated in this way and their associated persons will be treated as dual registrants.

Thank you for considering our comments. Should you have any questions, please contact me at

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Respectfully submitted,

Rick Dahl
Chief Compliance Officer, EVP