



August 7, 2018

**Via E-Mail**

Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090  
Via email to: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

**Re: File No. S7-07-18  
SEC Release No. 34-83061  
Regulation BI**

Dear Mr. Fields:

The Bank, Insurance, and Securities Association ("BISA") is submitting this letter in response to the request for comments in Release No. 34-83061 (the "Proposing Release") issued by the U.S. Securities and Exchange Commission (the "SEC" or the "Commission"), proposing Regulation Best Interest ("Regulation BI").<sup>1</sup>

**OVERVIEW OF BISA**

BISA is the leading financial services industry association dedicated to serving those responsible for the marketing, sales, and distribution of securities, insurance, and other financial products and advisory services through the bank channel. Member companies include depository institutions of all sizes from all regions across the United States, their broker-dealer and mutual fund subsidiaries, third-party marketing companies, product manufacturers, and firms providing products, technology, and services to support these enterprises. Our members are deeply intertwined with the distribution of securities products through bank-affiliated broker-dealers, and are constructively involved in enhancing the financial security of working Americans and retail investors.

BISA and its member companies generally support the SEC's proposals to enhance the standard of conduct for broker-dealers, and commend the SEC for taking the lead on the standard of conduct issue. However, we offer the following suggestions in our comments to improve and enhance Regulation BI so that it doesn't negatively impact the bank-affiliated brokerage business model.

The comments set forth below in this letter address BISA's main concerns with Regulation BI. We would be happy to meet with the SEC to discuss BISA's concerns in greater detail.

**BISA COMMENTS**

[Regulation BI Could Disadvantage Commission-Based Business Models by Defining "Financial Incentives" Too Broadly](#)

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<sup>1</sup> *Regulation Best Interest*, 83 Fed. Reg. 21574 (May 9, 2018).

Regulation BI would require broker-dealers, as well as any persons associated with the broker-dealer, when making recommendations of any securities transaction or investment strategies to retail customers, to act in the best interest of the retail customer at the time the recommendation is made. In addition, the broker-dealer or associated persons' recommendation must not place the interests of the broker-dealer or associated person ahead of the retail customer's interests.

Although the "best interest" standard is not specifically defined in the proposal, Regulation BI offers a "safe harbor," where compliance with each one of the following three conditions would satisfy the "best interest" standard: the Disclosure Obligation, the Care Obligation, and the Conflict of Interest Obligation. More specifically, the Conflict of Interest Obligation would require broker-dealers to maintain written policies and procedures to identify and disclose, or eliminate, material conflicts of interest associated with a recommendation. The Conflict of Interest Obligation would also require firms to establish procedures to identify, disclose, and mitigate (or eliminate) material conflicts of interest arising from financial incentives associated with the recommendation.<sup>2</sup>

BISA's membership consists of many bank-affiliated broker-dealers. As bank-affiliated broker-dealers, these entities rely on customer referrals from the banking entity for business, and then help manage the personal investment decisions and securities transactions for these retail customers. These bank-affiliated broker-dealers are typically compensated on a "commission" basis, whereby they receive certain transaction-based compensation for each securities transaction.

BISA's membership is concerned that Regulation BI, in particular the Conflict of Interest Obligation, would negatively impact the commission-based distribution model for bank-affiliated broker-dealers by defining "financial incentives" too broadly. For example, the SEC's proposing release offers a list of material conflicts of interest arising from "financial incentives" that includes, among other things, the "receipt of commissions or sales charges, or other fees or financial incentives."<sup>3</sup> BISA believes that this illustrative list is overbroad, as it would have the effect of requiring broker-dealers to either eliminate base commissions or mitigate them. The implication is that all compensation, even commissions, received by a broker-dealer is inherently conflicted and must be mitigated. Such a conclusion is inherently inconsistent with the SEC's overarching objective in Regulation BI of preserving retail customer choice between brokerage and advisory accounts.

Furthermore, such a conclusion risks significantly disadvantaging brokerage commission models in comparison to fee-based advisory business models. This result would have serious consequences for the bank-affiliated brokerage distribution model, which relies on commission payments to encourage distribution of important investment vehicles to retail customers. BISA encourages the SEC to embrace these commission-based business models, and urges the SEC not to issue a final rule that disfavors any particular distribution arrangement or compensation model.

#### Regulation BI Should Recognize Presumption that Existing Compliant Supervisory Practices Would Satisfy the Conflict Mitigation Requirement

The SEC's proposal suggested a non-exhaustive list of potential practices that broker-dealers could implement in order to mitigate "financial incentive" conflicts of interest. More specifically,

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<sup>2</sup> *Id.* at 21682.

<sup>3</sup> *Id.* at 21618.

the SEC noted that broker-dealers could comply with the mitigation requirements by adjusting their current systems of supervision and compliance, as opposed to creating new systems.<sup>4</sup>

However, the SEC did not address whether broker-dealers would need to enhance current mitigation measures, or whether those measures would be sufficient to mitigate “financial incentive” conflicts of interest. For instance, broker-dealers are currently subject to mitigation measures in rules from the Financial Industry Regulatory Authority, Inc. (“FINRA”) relevant to the supervision of securities recommendations,<sup>5</sup> as well as FINRA’s Report on Conflicts of Interest.<sup>6</sup>

BISA urges the SEC to clarify how these current mitigation measures and supervisory frameworks utilized by broker-dealers would satisfy the requirements of the Conflict of Interest Obligation. Without further guidance, firms will struggle to determine what would be viewed as sufficient “mitigation” of financial incentive conflicts. Moreover, BISA encourages the SEC to explicitly recognize a presumption that existing supervisory practices (assuming they are in compliance with regulatory requirements) would constitute a sufficient mitigation measure for financial incentive conflicts under Regulation BI.

#### The SEC Should Clarify the Distinction between Conflict “Mitigation” and “Elimination”

As discussed above, Regulation BI offers a “safe harbor” for compliance with the “best interest” standard. This “safe harbor” requires broker-dealers to meet certain conditions, including the Conflict of Interest Obligation, which requires firms to adopt procedures to identify, disclose, and mitigate (or eliminate) material conflicts of interest arising from financial incentives associated with the recommendation. This means that any conflict of interest arising from financial incentives must either be mitigated or eliminated, which implies that some conflicts are unable to be mitigated and must instead be eliminated.

As briefly discussed above, the SEC set forth an overly broad list of material conflicts of interest arising from “financial incentives” associated with a recommendation. The SEC stated that these conflicts would include, but not be limited to, “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., quotas, 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; and transactions that would be effected by the broker-dealer (or an affiliate thereof) in a principal capacity.”<sup>7</sup>

Given this overly broad and inclusive list, BISA urges the SEC to clarify which types of conflicts should be mitigated, and which conflicts are unable to be mitigated and therefore need to be eliminated entirely. Further, bank-affiliated broker-dealers often utilize sales contests, bonuses, and other differential forms of compensation referenced in the SEC’s proposing release. BISA’s members would appreciate the SEC clarifying how these forms of differential compensation could be adequately mitigated without being eliminated entirely.

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<sup>4</sup> *Id.* at 21618.

<sup>5</sup> See, e.g., FINRA Rules 2111 (Suitability) and 3110 (Supervision).

<sup>6</sup> See FINRA Report on Conflicts of Interest (Oct. 2013), available at <https://www.finra.org/sites/default/files/Industry/p359971.pdf>.

<sup>7</sup> *Regulation Best Interest*, 83 Fed. Reg. at 21618.

The Care Obligation Should Borrow from FINRA Suitability Language Rather than ERISA Language

In order to qualify for the Regulation BI's "safe harbor" discussed above, broker-dealers must also comply with the Care Obligation, which requires that broker-dealers exercise "reasonable diligence, care, skill, and prudence" in making securities recommendations. This language is drawn from the Employee Retirement Income Security Act of 1974 ("ERISA"), which uses that language in discussing the fiduciary duties of investment professionals in the retirement marketplace. Given this ERISA background, terms such as "diligence, care, skill, and prudence" are not well understood or well defined in the brokerage or securities industry. Broker-dealers may struggle to comply with the Care Obligation, as this ERISA language will be relatively unfamiliar with them.


BISA urges the SEC to consider using language in Regulation BI's "safe harbor" that more closely tracks FINRA's suitability rule, Rule 2111. Although certain parts of the Care Obligation borrow from FINRA's suitability rule, the "diligence, care, skill, and prudence" language does not have a reasonable analog in the FINRA rulebook. Not understanding the language means broker-dealers would be more likely to fail the Care Obligation requirement, which means broker-dealers (including BISA's member companies) would not be able to rely on the "safe harbor" to comply with Regulation BI.

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On behalf of BISA and its member companies, we thank you for considering these comments. We would welcome the opportunity to discuss these comments and engage in a productive dialogue with the SEC on these important issues.

Respectfully submitted,

**Bank Insurance & Securities Association**

BY:  BTM  
Jeff Hartney, Executive Director