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August 7, 2018

VIA ELECTRONIC SUBMISSION

Brent J. Fields
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
http://www.sec.gov/rules/proposed.shtml
rule-comments@sec.gov

Re: File No. S7-07-18
Securities and Exchange Commission Release No. 34-83062
The U.S. Securities and Exchange Commission Requests Comment on Proposed New Regulation Best Interest

Dear Secretary Fields:

The National Society of Compliance Professionals ("NSCP") submits this letter in response to the request by the U.S. Securities and Exchange Commission (the "Commission") for comments on proposed new Regulation Best Interest (the "Regulation") to address the standard of care owed by broker-dealers to retail investors. NSCP is a nonprofit, membership organization with approximately 2,000 members, and is dedicated to serving and supporting compliance professionals in the financial services industry in both the U.S. and Canada. To our knowledge, NSCP is the largest organization of securities industry professionals in the U.S. and Canada devoted exclusively to compliance. In light of NSCP's focus on compliance and compliance professionals, our comments will be limited to concerns that impact compliance programs and/or compliance professionals. NSCP begins its comments by commending the Commission for undertaking its review of the standard of care given and owed to retail investors, and for seeking comments on a proposed Regulation to address this standard of care.

I. The proposed best interest standard would unduly and improperly expand broker-dealers' liability and regulatory risk, and thereby increase their costs of compliance while potentially constricting retail customers' access to investment services.

A key premise of the proposed Regulation is that the broker-dealer business model remains a valid, vital and important method for delivering investment services to retail customers. Unfortunately, the proposed Regulation in its current form severely undermines this premise because the "best interest" standard set forth in the Regulation goes too far in elevating the standard of care to which broker-dealers and their registered representatives would be held.

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The Care Obligation section of Securities and Exchange Commission Release No. 34-83062 (the "Release") purports to describe a broker-dealer's obligation in forming and making recommendations to its retail customers. Although the Release recognizes that the broker-dealer have a "reasonable" basis for a recommendation, it proceeds to undermine that obligation by insisting that every recommendation be in the retail customer's best interest. This is not, as the Release argues, consistent with existing precedent. Rather, the "best interest" standard (ostensibly a fiduciary principle) improperly shifts the focus of the inquiry into whether the standard is met from the objective, *i.e.,* the reasonable, measurable conduct of a similarly situated service provider, to the subjective, i.e., the best interest of the particular customer. On top of this subjectivity, the temptation for customers to evaluate a firm's conduct through the lens of hindsight once the performance of a strategy or investment is known, versus recalling what was in his or her best interest at the time a recommendation was made, will make defending claims that recommendations were improper a battle of experts more than an inquiry into the facts.

Moreover, the proposed best interest standard shifts the risk of each recommendation from the retail customer, who by law and contract has the right and obligation to decide whether to accept the recommendation, entirely to the broker-dealer, which would not earn any different or additional compensation for bearing this additional risk.

Importantly, the proposed Regulation provides no alternative or reasonable opportunity to change the means by which broker-dealers are compensated, which are generally transaction-based. Indeed, a primary goal of the proposed Regulation's Conflict of Interests Obligation, generally speaking, is to ensure that the broker-dealer's compensation is minimized by requiring broker-dealer to place the interests of its customer ahead of its own financial interests. In addition, the proposed Regulation's compensation conflict elimination rubric fails to properly consider and address that product compensation structures are often established and governed by the prospectus filings of the issuers and product sponsors, over which retail broker-dealers have no control.

Further, the proposed Regulation is likely to have other varying consequences, many of which are negative. Some firms may decide to intentionally circumscribe their product offerings to an extreme degree to seek shelter in the proposed Regulation's notion that the reasonably available alternatives to consider would be limited to those available at the firm. Conversely, some firms may feel compelled to dramatically expand their product offerings to include a host of products that are poorly understood by the firm's registered representatives; therefore, making it more difficult and riskier for those firms to appropriately and reasonably evaluate all of the products and document the factors necessary to satisfy the "best interest" care obligation with respect to each recommendation.

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Finally, the Release's own discussion of the proposed Care Obligation reveals the excessive and undue burdens that would be imposed on every registered representative for each recommendation made to every retail customer, and each firm's Compliance Department in ensuring that the registered representative's consideration of the appropriate factors, including those that justify a more expensive security or investment strategy over another reasonable available alternative offered by the broker-dealer. Consequently, the burden and costs to the firms of: (i) supervising their registered representatives to ensure they are complying with the new standard with respect to every recommendation they make to their retail customers; (ii) developing adequate policies and procedures to meet the new standards; (iii) and identifying, collecting and maintaining all of the new records and information that would be required to demonstrate that each recommendation meets the new heightened standard; would assuredly increase exponentially.

Thus, NSCP thinks that the consequences of the adoption of the proposed Regulation in its current form likely would include a material reduction in the number of broker-dealer firms willing and able to service retail customers, a restriction on the variety and number of investment products that would be made available to retail customers, and increased costs for those broker-dealers that remain. We saw the beginnings of this effect after the U.S. Department of Labor sought to impose its own fiduciary standard (the "DOL Fiduciary Rule") on retail broker-dealers. And to the extent feasible under the new regime, such additional costs would likely, at least in part, be passed on to retail customers, including those of modest means who have the greatest need for accessible and affordable investment services.

II. The proposed best interest standard is ambiguous, and the proposed Regulation does not include adequate specific guidance regarding key aspects of the Regulation.

Several present and former Commissioners, including Commissioners Peirce, Stein and Piwowar, have voiced their concern regarding the lack of clarity provided in the proposed Regulation. Commissioner Peirce stated: ". . . the rule text is not sufficiently clear about what the Best Interest Standard is and how it relates to existing broker obligations."[1] Commissioner Stein asked: "If the commission does not define "best interest", will broker dealers and their customers understand their obligations?"[2] Former Commissioner Piwowar noted: "On a basic level, ambiguity in this rule would make it difficult for broker-dealers to know how to comply with its requirements . . . "[3] If several of the Commissioners are confused and concerned about the vagueness of the proposal, it is very likely that many of the Commission's staff, Financial Industry Regulatory Authority, Inc. ("FINRA") staff, the broker-dealer industry, and importantly, retail customers will be confused.

1 https://www.sec.gov/news/public-statement/statement-peirce-041818

2 http://www.investmentnews.com/article/20180609/FREE/180609894/does-the-sec-really-need-to-define-best-interest

3 https://www.sec.gov/news/public-statement/statement-piwowar-041818

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The fact that the term and concept of “best interest” is used and defined in other contexts in federal and state laws and regulations further highlights the need for more precise definition and guidance to reduce the risk that the Regulation’s use of the term will be misconstrued or altered by reference to the term’s use in those other contexts. And given that the DOL Fiduciary Rule has been vacated, there is no need for the Commission to simply adopt the DOL’s nomenclature, and especially do so without definition and definitive guidance.

In addition to the anticipated confusion about the central component of the proposed Regulation in its current form, there are several other aspects of the proposed Regulation that need further amendment, refinement, and clarification through specific guidance.

For example, the Regulation does not address in any respect the undeniable fact that the experience levels and access to resources vary widely among registered representatives at different firms. Consequently, this aspect of the proposed Regulation has the danger of creating disincentives for new entrants in the business, at a time when the investment services needs of American investors are already underserved.

Also, the Release’s commentary concerning recommendations of “identical” securities is misleading and incapable of harmonization. There are a variety of factors that make each security “different”/“non-identical”, including past performance, investment management personnel, investment management style, investment philosophy, investment composition, investment objective, insurance benefit, compensation, and cost. As noted above, the vague notions referenced in the commentary concerning “identical” investments and “reasonable alternatives”, without more guidance, make the burden of gathering and keeping records sufficient to demonstrate the appropriateness under the proposed standard of each recommendation to each retail customer overwhelming.

Separately, NSCP believes the broad-brush definition of “retail customer” in the proposed Regulation appears to reach too far. The definition is not problematic for purposes of requiring that firms provide the Customer Relationship Summary and other newly proposed disclosures to the additional categories of customers included in the proposed Regulation’s definition of “retail investor.” However, including a retail customer’s legal representative or duly authorized agent under the purview of this Regulation without limitation would potentially make broker-dealers responsible for the decisions of other fiduciaries, even though those other fiduciaries already have that responsibility and are being compensated therefor.

As a matter of course, broker-dealers often perform reviews of account types pursuant to internal policies and procedures, or related discussions with customers. Nevertheless, the proposed Regulation should not impose the obligation to perform ongoing or periodic evaluation of account type for each retail customer. This would likely add unnecessarily to each firm’s increased compliance

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costs and legal and regulatory risk.

The proposed Regulation should be limited to recommendations made by registered representatives, and not all associated persons who are natural persons. In this regard, any associated person who is not duly authorized to make such recommendations already would be subject to regulatory and/or disciplinary action.

III. The proposed Regulation unfairly and unduly burdens small broker-dealers.

As noted, the substantial additional compliance implementation costs and the costs resulting from increased litigation and regulatory enforcement risk would likely lead broker-dealers throughout the industry to cease operations, reduce their product offerings or otherwise restructure their businesses. Given the magnitude of the expected increase in costs, it is beyond genuine dispute that smaller broker-dealer firms would be disproportionately impacted, and therefore the number of small firms in business likely would decline further and retail customers' access to investment services likely would be further restricted. This is at a time when the broker-dealer population is already dramatically declining.

In a 2017 report entitled *Dwindling Numbers in the Financial Industry,* Commissioner Peirce writes that the number of broker-dealers has declined by more than 30% in the last 10 years and "not surprising that small BDs make up a disproportionate share of the BD decline". Ms. Peirce goes on to say that the industry is highly regulated and asserts that regulation is "likely an important factor" in the decline. She notes: "SEC restrictions have increased by almost thirty percent" since the year 2000, noting that these figures do not take into consideration any regulatory changes by self-regulatory organizations, including FINRA. The implications of the steady decline in the number of broker-dealers, according to Commissioner Peirce, are significant: "If industry exit is driven by regulation, rather than economics of the marketplace, the industry can become non-competitive. Constrained competition decreases customer choice. Moreover, if regulatory barriers prevent new entrants with new ideas, technologies, and business models from displacing existing firms, customers may be denied higher quality or more affordable service."

To comply with the flood of new regulations promulgated over the last several years, small broker-dealer firms have had their resources strained both financially and operationally. Many firms have been examined numerous times by several different regulators in recent years, regardless of the results of those examinations. Several small firms estimate that they incur approximately $80,000 in compliance costs to meet basic ongoing regulatory requirements. Notably, this amount does not include expenses associated with new rules, regulatory changes, regulatory exams or running a compliance department.

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In isolation, it may seem that this single proposal by one regulatory agency would have manageable marginal impact on costs. But in fact, it would be one of many changes (and importantly, a major change) that smaller firms must address.

Many small firms do not have large Compliance Departments adequate to shoulder these ever-increasing regulatory demands. In fact, many small firm Compliance Departments are comprised of just one or two persons. Yet, just like large firms, small firms must train employees and registered persons on each new rule and regulation, and update policies, procedures, systems and record-keeping to keep pace with the adoption of new rules and regulations. Oftentimes, of necessity, small firms must engage outside vendors, and invest in new systems and tools. In sum, the operational and compliance capacity of small firms is already strained to the breaking point. Consider the estimated $60,000 in additional compliance costs referenced in the Release which would represent 12% of net capital of a $500,000 firm. The additional compliance burdens imposed by the Regulation may also force many small firms to hire additional compliance personnel.

Further, small firms with businesses focused on institutional customers (as currently defined by FINRA Rule 2111) will have to make wholesale changes and major costly investment in entirely new systems to track and document the obligations, particularly the proposed Care Obligation, for many of their clients that fall within the proposed regulation's current definition of "retail customer." Therefore, NSCP respectfully urges the Commission to further consider the financial and operational impacts of the proposed Regulation, particularly on small firms, and revise the proposed Regulation to minimize those impacts.

The proposed Regulation negatively impacts dual registrants.

Currently, many dual registrants employ policies and procedures which contemplate that their registered representatives' dealings with retail customers are governed by the broker-dealer regulatory regime unless and until there is a written contract establishing an investment advisory relationship. This approach is appropriate, practical and cost-efficient. The proposed Regulation, however, may cause dual registrants to take the opposite approach, which would be detrimental to those firms.

The adverse impact of the proposed Regulation on dual registrants arises from (among many of the other considerations and factors mentioned) the danger and potentially unintended consequence that, in order to minimize the burden and business disruption, and avoid the pitfalls, of the complications introduced by the proposed new standard governing dual registrants' broker-dealer activity, dual registrants would require their registered representatives to adhere to the investment adviser fiduciary standard across all business line activities. Such decisions, driven by practical considerations, would potentially have the consequence of exposing such dual registrants and their registered persons to the risks, increased liability exposure and additional compliance burdens and

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costs which attend the investment adviser fiduciary standard, even though such dual registrants would not and could not be compensated as an investment adviser. Such an outcome would unfairly put dual registrants at a competitive disadvantage.

The Regulation further disproportionately impacts small dual registrant firms which are already struggling under the burden and difficulty of making and monitoring the confusing determinations of when their representatives are acting as broker-dealers or investment advisers.

Finally, the proposed Regulation would disproportionately complicate and burden the efforts of dual registrants' registered representatives to prospect and market to potential retail customers by imposing additional confusing and overly burdensome disclosure requirements at the outset of their interaction with potential customers.

IV. The main goals of the proposed Regulation can be accomplished by adopting and enhancing the existing FINRA suitability standard, which will allow Compliance Departments to more efficiently utilize and build on the substantial and expansive policies, procedures, systems and personnel already in place.

The proposed Regulation's additional disclosure requirements, and the concept of requiring that financial conflicts be not only disclosed, but eliminated, of the proposed Regulation are laudatory and consistent with some of the already existing requirements governing ERISA accounts held at broker-dealer firms. Thus, NSCP believes that these aspects of the proposed Regulation would be manageable from a compliance perspective.

However, NSCP also believes that FINRA Rule 2111 (the "Suitability Rule") is intended to, and does in fact, promote ethical sales practices and high standards of professional conduct. Therefore, NSCP on behalf of its broker-dealer compliance professional constituents, respectfully urges the Commission to reconsider its approach and, instead of promulgating a vague and unduly burdensome new regime, explicitly adopt the FINRA Suitability Rule and make those additions and enhancements to the standard defined therein that are necessary and appropriate to achieve the disclosure, and mitigation or elimination of conflicts objectives that are at the essence of the proposed Regulation. Such an approach would enable broker-dealer firms to much more efficiently and cost-effectively utilize and enhance the systems, policies, procedures and personnel they already have in place to meet the new requirements and goals of the proposed Regulation. Moreover, such an approach would more appropriately acknowledge and more effectively account for the important differences between broker-dealers and investment advisers, including their differing customer relationship, compensation and business models features and structures.

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We commend the Commission for giving us this opportunity to present our views on the Regulation to address the standard of care owed by broker-dealers to retail investors. NSCP would welcome the opportunity to answer any follow-up questions that the Commission may have regarding this submission, or to provide such further assistance as the Commission may request.

Thank you for your attention to these comments. Questions regarding the foregoing should be directed to the undersigned at [redacted].

Sincerely,

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