Occupy the SEC
http://www.occupythesec.org

August 7, 2018

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC
20549-1090

Re: Regulation Best Interest (File Number S7-07-18)

Dear Mr. Fields:

Occupy the SEC[1] ("OSEC") submits this comment letter in response to the notice of proposed rulemaking issued by the Securities and Exchange Commission ("Commission") regarding the standard of conduct that should apply to broker-dealers when making recommendations about securities to retail customers.

We believe that the Commission's proposed Regulation Best Interest ("Reg BI") is deeply flawed because it does not adopt a fiduciary standard for broker-dealers. In crafting Reg BI, the Commission has failed to meet its stated goals of protecting retail customers and clarifying the standard that applies when broker-dealers provide advice. As explained below, the agency has also failed to heed the statutory requirements of the Dodd-Frank Act.

The proposal claims that it "seek[s] to establish greater consistency in the level of protection provided across the spectrum of registered investment advice."[2] Yet, far from establishing consistency, Reg BI creates a novel standard for broker-dealers that is entirely distinct from the long-standard fiduciary rule that has applied to investment advisers for over 70 years.

Indeed, despite taking up over 100 pages of the Federal Register, Reg BI is little more than a reaffirmation of the status quo. We echo Commissioner Kara Stein's remarks in this regard.[3]

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[1] Occupy the SEC (http://occupythesec.org) is a group of concerned citizens, activists, and financial professionals that works to ensure that financial regulators protect the interests of the public, not Wall Street.

[2] Regulation Best Interest, 83 Fed. Reg. 21,574, 21,576 (proposed May 9, 2018) [hereinafter Proposed Rule].

[3] *See* Commissioner Kara M. Stein, Statement on Proposals Relating to Regulation Best Interest, Form CRS, Restrictions on the Use of Certain Names or Titles, and Commission Interpretation Regarding the

While the Best Interest standard is admittedly more stringent in theory than the pre-existing suitability standard, the proposal nevertheless adds little value to the practical regulatory regime that actually governs brokers-dealers and protects investors. The proposal itself admits that many of the additional requirements that Reg BI imposes merely "reflect obligations that already exist under the FINRA suitability rule or have been articulated in related FINRA interpretations and case law."[4] Even if Reg BI were *not* adopted, broker-dealers would still be practically required to make recommendations that are consistent with the customer's best interest.[5] Thus, despite its verbosity, Reg BI appears to provide little practical benefit.

Reg BI is especially troubling because, through the usage of the words "Best Interest," the regulation signals to the lay public that broker dealers will henceforth always act in the investor's best interest (i.e., act as fiduciaries). However, the Commission's proposal is littered throughout its 109 pages with innumerable exemptions, loopholes and exceptions that belie the notion that brokers must act in the investor's best interest at all times. Simply put, "Regulation Best Interest" is a dangerous misnomer.

Reg BI only requires that a broker-dealer consider the customer's best interest in cases where an explicit recommendation is made. In a plethora of other scenarios – such as transactions involving proprietary products or third-party kickbacks – the broker dealer need not vindicate the customer's best interest. This point will be apparent to lawyers and sophisticated investors who parse through Reg BI's 109 pages. But it will be far from clear to the lay investor, who will mistakenly conflate the "Best Interest" with the more familiar standards established under the common law concept of fiduciaries.

That concept benefits from centuries of precedent that has helped settle expectations in the market and among consumers about the kind of activities that are permissible and those that are not. Instead of relying on this stable body of precedent, the Commission's Reg BI attempts to re-invent the wheel with its own amorphous and poorly defined standards for Disclosure, Care and Conflict of Interest. The Commission itself has had extensive experience in defining the terms of the fiduciary concept in the context of investment advisers. It is therefore perplexing that the agency would establish an entirely different regime for broker-dealers, in defiance of the Congressionally-mandated recommendations of its own staff (i.e., the "913 Study").

The convoluted nature of Reg BI is also troubling because it could impede the later adoption of a true fiduciary standard for broker dealers. We suspect that future, more progressive administrations may have a stronger appetite for a uniform fiduciary standard than the current Executive. If Reg BI were adopted in current form, it would create an unduly complex rubric that would be difficult to unravel in favor of a simpler fiduciary standard.

The Commission expresses concern that a strong regulatory regime (i.e., a uniform fiduciary standard) could "cause investors to lose choice" and inhibit their ability to pay for advice through

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Standard of Conduct for Investment Advisers (Apr. 18, 2018), *available at* https://www.sec.gov/news/public-statement/stein-statement-open-meeting-041818.

[4] Proposed Rule at 21,576 n.7.

[5] *Id*. at 21,575 n.6 (citing the influence of SRO caselaw on this issue).

brokerage commissions.[6] While we commend the Commission for its solicitude about investors' buying options, we nevertheless wish to point out that this reasoning comes across as quite disingenuous. The truth is that the Commission has come under tremendous pressure from industry lobbyists and industry-friendly politicians (both within and without the Commission) to torpedo the fiduciary rule because of fears that it would **harm broker-dealer profits**. While investor choice may no doubt have been a secondary or tertiary consideration, the Commission's solicitude for **broker-dealer profits** is plainly a primary motivation behind the feckless Reg BI proposal. The Commission's attempts to window-dress that primary motivation as concern for investor choice comes across as suspect and unseemly. Indeed, judging from the non-industry comment letters submitted on this issue so far, it would appear that the vast majority of investors seem to be more interested in the benefits to be enjoyed from a fiduciary standard for broker-dealers, and less concerned about the lack of "choice" attendant to that standard.

In any case, anxiety about the loss of the commission-based model is a poor reason for the Commission to have abandoned the fiduciary standard. We acknowledge that Section 913 of the Dodd-Frank Act seeks to safeguard the commission-based model for broker-dealers. Still, the Department of Labor had no trouble adopting a robust fiduciary standard on the one hand, and crafting an exemption (i.e., Best Interest Contract Exemption ("BICE")) for commissions on the other. The Commission could easily have adopted a similar approach. It has neglected to do so.

Instead, the Commission's approach focuses inordinately on commission-based recommendations, to the exclusion of a host of other important considerations relating to investors' "best interest." Reg BI turns what should be an exception for commission-based advice into a rule, and in the process jettisons the vital corpus of broad fiduciary protection.

It should be noted that the broker-dealer market itself may not fundamentally justify the Commission's anxiety about the elimination of the commission-based model. That market is already shifting towards innovative fee-based models like clean shares and T-shares. And financial stalwart Merrill Lynch had no trouble in announcing a ban on commissions in retirement accounts when the DOL first announced its fiduciary rule.[7] The Commission should implement robust regulations that allow the market to evolve in a pro-investor, pro-efficiency direction, rather than safeguarding outmoded compensation models that harm investors and line the pockets of the financial services industry.

The Commission's Reg BI is also problematic because it is without statutory authorization. Under Section 913(g) of the Dodd-Frank Act, "[t]he Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers . . . shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice."[8] Section 913(g) was not a statute of general

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[6] *Id*. at 21,583.
[7] *See* Greg Iacurci, *Merrill Lynch Eliminates Commission IRA Business in Response to DOL Fiduciary Rule*, Investment News, Oct. 6, 2016, *available at* http://www.investmentnews.com/article/20161006/FREE/161009942/merrill-lynch-eliminates-commission-ira-business-in-response-to-dol.
[8] 15 U.S.C. 80b–11(g)(1) (2017); 15 U.S.C. 78o(k)(1) (2017).

authorization granting the Commission discretion to adopt any standard for broker-dealers that it felt were appropriate. Instead, under this section, Congress granted the Commission authorization to promulgate a rulemaking with a specific, uniform requirement: that the investment advice rendered by a broker-dealer be "without regard to [his] financial or other interest."

If Congress intended to further delimit the scope of this prohibition on conflicts, it could have done so. Instead, it chose expansive language that harmonized the standard applicable to broker-dealers with the well-established fiduciary standard that applies to investment advisers. Reg BI flouts Congress's express mandate by adopting an **entirely different** standard ("without placing the financial or other interest . . . ahead of the interest of the retail customer") that undermines the intent and plain meaning of Section 913(g).[9]

The Commission is attempting to interpose a novel standard that contradicts the clear wording of Congress. Courts will overturn an agency's informal rulemaking when that rule is in excess of statutory authorization.[10] If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.[11] Perhaps the Commission would have preferred if Congress had mandated a different, more lax approach. Even so, the Commission must proceed per the plain words of Section 913(g), and not its own political preferences.

The Commission is completely misguided to the extent that it believes that its own standards for Disclosure, Care and Conflict of Interest under Reg BI will interplay seamlessly with pre-existing standards under the fiduciary. Reg BI uses many of the same terms that apply to fiduciaries (such as care, disclosure, conflict of interest, best interest, etc.) but with significant differences, limitations, and exceptions.

If it adopts Reg BI, the Commission will set the stage for decades of confusion regarding the exact contours of these seemingly-similar-yet-disparate standards. Courts will be needlessly burdened with the task of winnowing out the differences between the standards. Investors will presume – to their financial detriment – that broker-dealers must always safeguard the investor's best interest. And broker-dealers themselves will ultimately face unexpected liabilities based on their own misapprehension of an unduly labyrinthine rule.

The fiduciary standard would have provided all participants with a clear, photographic picture of the required standard of conduct for broker-dealers. Unfortunately, Reg BI is more akin to an impressionist painting, with ill-defined boundaries that are subject to subjective interpretations.

We urge the Commission to re-propose this rule under the fiduciary standard.

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[9] As noted above, Section 913(g)'s safe harbor for commission-based compensation is not inconsistent with a fiduciary standard, which is apparent from the DOL's approach to the issue.
[10] *See* 5 U.S.C. §706 (2017).
[11] *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U. S. 837, 842-43 (1984).

Thank you for your attention to this matter of great public interest.

Sincerely,
/s/
Occupy the SEC

Akshat Tewary
Neil Taylor
et al.