

Proposed Best Interests of the Customer Standard for Broker-Dealers (Preamble)

1. For over six years – predating the passage of the Dodd-Frank Act – SIFMA has strongly supported SEC action to establish a uniform fiduciary standard for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. To this day, SIFMA continues to strongly support Securities and Exchange Commission (SEC) action under Dodd-Frank § 913 and we will continue to work with the SEC to achieve that goal.
2. In the meantime, however, SEC Chair White has stated, most recently in her March 24, 2015 testimony before the House Financial Services Committee, that SEC progress under Dodd-Frank § 913 will take time and will not be accomplished in the near term.
3. Even more recently, on April 14, 2015, the Department of Labor (DOL) re-proposed its definition of who is a fiduciary under ERISA, and created a “best interests” contract (“BIC”) exemption for, among others, broker-dealers who service IRA accounts.
4. The DOL re-proposal would create, among other things, an additional standard of care that would apply only to recommendations made by broker-dealers to retail customers in retirement accounts (and not to recommendations made in any other brokerage account). As a result, SIFMA believes the DOL re-proposed standard, with its applicability limited to tax deferred retirement accounts, would likely add to investor confusion, and result in regulatory duplication and inefficiency.
5. SIFMA shares the collective interest in enhancing investor protections; however, we believe it should be accomplished by establishing a uniform best interests of the customer legal standard for broker-dealers that applies to all retail brokerage accounts. We believe this goal could be accomplished in a manner that is consistent not only with SIFMA’s historical position and § 913, but also with the best interest standard set forth in the DOL BIC, and without certain conditions and requirements currently contained in the BIC.
6. An optimal “best interests of the customer” legal standard for broker-dealers should:
 - i. apply across all investment recommendations made to individual retail customers in all brokerage accounts (not just limited to IRA accounts);
 - ii. serve as a benchmark for, be consistent with, and integrate seamlessly into, the SEC uniform fiduciary standard that ultimately emerges under Dodd-Frank § 913;
 - iii. provide interim, strong, substantive, “best interests” protections for retail customers; and
 - iv. follow the traditional securities regulatory approach of establishing a rules-based heightened standard, including robust disclosure, coupled with robust examination, oversight, and enforcement by the SEC, FINRA and state securities regulators, as well as a private right of action for investors.
7. FINRA CEO Ketchum, in his remarks at the FINRA Annual Conference on May 27, 2015, reinforced many of these same points. “It is not optimal,” he stated, “to apply a different legal standard to IRAs and 401(k)s than to the rest of an investor’s assets.” A broker-dealer best interests standard, Ketchum stated, should be established under the securities laws, building upon “the effectiveness and fundamental integrity of the present FINRA/SEC regulatory structure.” Otherwise, we run the risk of bifurcation, redundancy, investor confusion, and market disruption.
8. SIFMA supports the securities regulators, specifically FINRA and the SEC, moving forward to establish a uniform best interests of the customer standard for broker-dealers when providing personalized advice about securities to retail customers. Any consideration by the DOL to adopt a best interests standard should be consistent with a prospective FINRA/SEC standard.

9. Accordingly, given SIFMA's long-standing support for a best interests or fiduciary standard, including our extensive public comments since 2009 before Congress and the securities regulators, and in order to provide a path forward for policymakers to establish a uniform standard that applies across the retail marketplace, in lieu of a bifurcated system, SIFMA is now providing further delineation of a best interests standard.
10. SIFMA believes that this standard could be articulated, for example, through amendments to existing FINRA Rules, as approved by the SEC. The standard would include the following core elements:
 - i. articulate a legal and enforceable best interests obligation,
 - ii. consider investment-related fees as part of the best interests standard,
 - iii. avoid and/or manage material conflicts of interest, and
 - iv. provide disclosures about material conflicts and investment-related fees to enhance transparency.
11. Again, FINRA CEO Ketchum, in his most recent remarks, touched upon these same core elements in suggesting how a best interests standard should be crafted.
12. The following is a mark-up of existing FINRA Rules that outlines the broad contours of how a best interests standard for broker-dealers might be developed as part of the path forward on this most important investor protection issue. SIFMA believes that this standard is consistent with (i) SIFMA's historical position, (ii) Dodd-Frank § 913, (iii) the evolution of a best interests regime under FINRA Rules, and (iv) the DOL's specific definition of a best interests standard under the BIC exemption.

Proposed Best Interests of the Customer Standard for Broker-Dealers

The following SIFMA mark-up of existing FINRA Rules is intended to be fairly streamlined and high-level in order to focus attention on, and promote discussion about, the core elements of a proposed best interests of the customer standard for broker-dealers. Missing from this treatment are, among other things, key details about how the standard would operate under various scenarios, and the content, timing and manner of disclosures and consents, if any, all of which are of critical significance to SIFMA's members.

2111. Suitability The Best Interests of the Customer

- a. A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for in the best interests of the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.

i. The best interests standard. A best interests recommendation shall:

1. Reflect the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the customer's investment profile (defined above). The sale of only proprietary or other limited range of products by the member shall not be considered a violation of this standard.
2. Appropriately disclose and manage investment-related fees. See *Manage investment-related fees* below.
3. Avoid, or otherwise appropriately manage, disclose, and obtain consents to, material conflicts of interest, and otherwise ensure that the recommendation is not materially compromised by such material conflicts. See *Manage material conflicts of interest* below.

ii. Manage investment-related fees. A member shall ensure that investment-related fees incurred by the customer from the member are reasonable, fair, and consistent with the customer's best interests. Managing investment-related fees does not require recommending the least expensive alternative, nor should it interfere with making recommendations from among an array of services, securities and other investment products consistent with the customer's investment profile.

iii. Manage material conflicts of interests. A member or associated person shall avoid, if practicable, and/or mitigate material conflicts of interest with the customer. A member or associated person shall disclose material conflicts of interest to the customer in a clear and concise manner designed to ensure that the customer understands the implications of the conflict. The customer shall be given the choice of whether or not to waive the conflict, and must provide consent, as provided in Rule 2260 (Disclosure). Notwithstanding the disclosure of, and customer consent to, any material conflict, a recommended transaction or investment strategy must nevertheless be in the best interests of the customer.

iv. Provide required disclosures. A member or associated person shall provide and/or otherwise make available to the customer, among other things: 1) account opening disclosure, 2) annual disclosure, and 3) webpage disclosure, as provided in Rule 2260 (Disclosure).

- b. A member or associated person fulfills the customer-specific suitability obligation for an institutional account, as defined in Rule 4512(c), if (1) the member or associated person has a reasonable basis to believe that the institutional customer is capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies involving a security or securities and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the member's or associated person's recommendations. Where an institutional customer has delegated decisionmaking authority to an agent, such as an investment adviser or a bank trust department, these factors shall be applied to the agent.

2260. Disclosures

a. Account opening disclosure. A member or associated person shall disclose to the customer, at or prior to the opening of the customer account, or prior to recommending a transaction or investment strategy, if earlier, the following:

- the type of relationships available from the broker-dealer and the standard of conduct that would apply to those relationships;
- the services that would be available as part of the relationships, and information about applicable direct and indirect investment-related, fees;
- material conflicts of interest that apply to these relationships, including material conflicts arising from compensation arrangements, proprietary products, underwritten new issues, types of principal transactions, and customer consents thereto; and
- disclosure about the background of the firm and its associated persons generally, including referring the customer to existing systems, such as FINRA's BrokerCheck database.

b. Annual disclosure. A member shall disclose to the customer annually a good faith summary of investment-related fees incurred by the customer from the member or associated person with respect to all products and services provided during the prior year (or such shorter period as applicable).

c. Webpage disclosure. A member's webpage shall provide disclosure that is concise, direct and in plain English, following a layered approach that provides supplemental information to the customer. A member's webpage shall include access to all account opening disclosure. Paper disclosure shall be provided to customers that lack effective Internet access or that otherwise so request.

d. Customer consent. Customer consent to material conflicts of interest or for other purposes as appropriate may be provided at account opening.¹ Existing customers with accounts established prior to the effective date of the best interests standard shall be deemed to have consented to the material conflicts of interest, if any, disclosed to the customer, upon continuing to accept or use account services.

e. Disclosure updates. Updates to disclosures, if necessary or appropriate, may be made through an annual notification that provides a website address where specific changes to a member's disclosure are highlighted.

¹Customer consent to principal transactions, for example, could be provided at account opening.