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December 1, 2023

Via E-Mail to: NASAAComments@nasaa.org, kopletona@dca.njoag.gov and jnix@ilsos.gov

North American Securities Administrators Association, Inc. (NASAA)
Attn: Amy Kopleton, Group Chair, Broker-Dealer Market and Regulatory Policy and Review Project, and James Nix, Chair, Broker-Dealer Section
750 First Street, N.E., Suite 990
Washington, D.C. 20002

Re: SIFMA Comment on Proposed Revisions to NASAA's Dishonest Or Unethical Business Practices of Broker-Dealers Model Rule

Dear NASAA, Ms. Kopleton, and Mr. Nix:

The Securities Industry and Financial Markets Association (***"SIFMA"***)[1] appreciates the opportunity to comment on the North American Securities Administrators Association, Inc. (***"NASAA"***) proposed revisions to its "Dishonest or Unethical Business Practices of Broker-Dealers and Agents" (the ***"Proposal"***).[2] We respectfully submit the following comments and recommendations for your consideration.

The Proposal's stated purpose is to incorporate the SEC's Regulation Best Interest (***"Reg BI"***), including the SEC's related interpretive guidance on Reg BI, into NASAA's broker-dealer model rule. The Proposal's language and effect, however, diverge significantly from Reg BI. In practice, NASAA's proposed language changes would fundamentally rewrite the existing regulatory regime, including Reg BI, under which broker-dealers provide services to investors.[3]

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed-income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit http://www.sifma.org.

[2] https://www.nasaa.org/wp-content/uploads/2023/09/Request-for-Public-Comment-on-BD-Best-Interest-Model-Rule.pdf.

[3] *See* Appendix 2, prepared by A. Valerie Mirko, Armstrong Teasdale LLP, for a side-by-side comparison of the numerous, significant differences between the Proposal and Reg BI.

There is a growing consensus that Reg BI is increasingly well-functioning and effective in protecting investors after more than three-years of closely-watched regulatory examinations, enforcement actions, and an ever-growing body of regulatory guidance.[4] NASAA itself concedes that broker-dealer firms have demonstrated "helpful and steady implementation progress" as they have "update[ed] their investor profile forms and enhance[ed] their policies and procedures to focus more directly on Reg BI obligations."[5]

The regulatory rewrite contemplated by the Proposal would not only directly conflict with Reg BI, but also undermine the regulatory regime's future development and progress. In doing so, the Proposal would negatively impact retail investors and undercut the primary objective of Reg BI, namely, to preserve investor choice among brokerage products and services, and to preserve investor access to full-service and self-directed brokerage and investment advisory accounts. The Proposal would likewise increase costs and uncertainty for investors, given the breadth and vagueness of its requirements, as discussed below.

To the extent NASAA believes it is necessary to augment the existing regulatory regime, our industry stands ready to engage constructively with you to address your concerns in an appropriately targeted manner. In this regard, we note that historically, NASAA has expressed concerns with certain complex products.[6] In the Proposal, NASAA also expresses concerns with emerging technologies and firms' digital engagement practices.[7] Assuming complex products and new technologies are the primary concerns, we believe the Proposal should be set aside in favor of exploring a more narrowly tailored approach to address these specific concerns.

NASAA should also ensure that any of its model rule amendments are closely coordinated and aligned with the actions of federal regulators, particularly the SEC and the Department of Labor (***"DOL"***). Regulatory alignment and consistency reduce investor confusion and foster investor protection. The DOL just recently proposed a new rule governing fiduciary advice to retirement accounts.[8] Meanwhile, the SEC is currently vacillating between two arguably competing approaches to firms' digital engagement practices and predictive data analytics.[9] NASAA should allow these two major developments to play out to conclusion prior to drafting new rules that may ultimately prove to be misaligned and/or inconsistent with those efforts.

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[4] *See, e.g.*, FINRA Highlights Firm Practices from Regulation Best Interest Preparedness Reviews (Feb. 2023), https://www.finra.org/rules-guidance/key-topics/regulation-best-interest/preparedness.

[5] NASAA National Exam Initiative Phase II (B) Report (Sept. 2023) (***"NASAA Report"***) at pp. 3-4, https://www.nasaa.org/wp-content/uploads/2023/08/Reg-BI-Phase-II-B-Report-Formatted-8.29.23.pdf.

[6] *See* NASAA Report at pp. 4-8.

[7] Preamble to Proposal at pp. 6-7 and fn 14.

[8] DOL Proposed Retirement Security Rule (Oct. 24, 2023), https://www.dol.gov/sites/dolgov/files/ebsa/temporary-postings/retirement-security-rule-definition-of-an-investment-advice-fiduciary.pdf.

[9] *See* discussion Part I.1.b. *infra*.

Finally, on the same theme that regulatory consistency fosters investor protection, we urge NASAA *not* to invite states to adopt "one, some, or all" of the subparts of the Proposal.[10] Doing so would likely result in an uneven patchwork of different standards across the fifty states. The corresponding negative impacts to retail investors may include greater cost, less choice, and confusion over what "best interest" standard they are owed in any given state.

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Executive Summary

As discussed in greater detail below, the Proposal would impose obligations that conflict with and/or differ from the requirements of Reg BI, and the National Association of Insurance Commissioner's "Suitability in Annuity Transactions Model Regulation" (***"NAIC Best Interest Model Rule"***), and that are otherwise federally preempted. The vast majority of the language of the Proposal is unnecessary to incorporate Reg BI, and NASAA's invitation for states to adopt a multitude of variations of the Proposal would likely result in a patchwork of inconsistent regulations among the states. For these reasons, among others, we recommend that NASAA withdraw the Proposal.

- The Proposal directly conflicts with Reg BI in three major respects:
  - the redefinition of what constitutes a "recommendation" (Subpart 1.d.(5));
  - the rewriting of the Conflict of Interest Obligation under Reg BI (Subparts 1.d.(1) and (2)); and
  - the treatment of "cash or non-cash compensation" (Subpart 1.d.(2)b.)
- The Proposal also directly conflicts with Reg BI in five other respects:
  - the expansion of customer profile information;
  - the misstatement of the "reasonably available alternatives" obligation;
  - the treatment of "costs;"
  - the inconsistent definition of "retail customer;" and
  - the titling provision.
- The foregoing conflicts would negatively impact retail investors by limiting their choice of brokerage products and services and reducing their access to brokerage accounts, including self-directed brokerage accounts.
- The Proposal is in large part federally preempted under both NSMIA and Reg BI.
- The Proposal conflicts with the NAIC Best Interest Model Rule.

[10] *See* discussion Part V. *infra*.

- The majority of the Proposal is unnecessary to incorporate Reg BI into state securities regulations; regardless, the language incorporating Reg BI should be conformed to align with the actual language of Reg BI.

- The Proposal would create a patchwork of inconsistent regulations among the states.

- The Proposal inappropriately incorporates SEC staff guidance into a new model rule for adoption by various states.

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I. The Proposal conflicts with Reg BI in three major respects.

Revision #2 to the Proposal adds eight subparts to Section 1.d., labeled (1) through (8). Each subpart is purportedly intended to define or clarify various obligations under Reg BI, based upon existing SEC staff guidance. Nowhere in the Proposal, however, does NASAA explain or justify why it is necessary or appropriate to incorporate SEC staff guidance into the rule text,[11] or whether and how Reg BI, as drafted, is not properly protecting retail investors. As discussed below, these eight subparts deviate significantly from, and directly conflict with, the plain language of Reg BI, and are otherwise federally preempted.[12] Accordingly, Revision #2 and its eight subparts should be stricken from the Proposal.

By far, the most problematic provisions in Revision #2 are: (i) the redefinition of what constitutes a "recommendation;" (ii) the rewriting of the Conflict of Interest Obligation under Reg BI; and (iii) the treatment of "cash or non-cash compensation." We address each in detail below:

1. The Proposal vastly and inappropriately expands the definition of "recommendation" under Reg BI (Subpart 1.d.(5)).

Subpart 1.d.(5) of the Proposal states:

> *"The obligations set forth in this section do not apply to unsolicited transactions that a broker-dealer or agent execute for a customer in a self-directed or nondiscretionary account. If the broker-dealer or agent utilized* ***any means, method or mechanism to feature or promote*** *an account type, specific security or investment strategy to a retail customer, whether directly or through a third-party, then that transaction will not be deemed an unsolicited transaction, but rather will be deemed a recommendation to which all of the foregoing obligations set forth in this subsection apply."* (emphasis added).

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[11] *See* Section VI *infra* for a discussion of why it is inappropriate for NASAA to propose to incorporate SEC staff guidance into a potential new model rule for adoption by various states.

[12] *See* Appendix 1, explaining why the Proposal is in large part federally preempted.

This language constitutes a wholesale redefinition of what constitutes a recommendation under Reg BI and long-standing SEC and FINRA interpretations and guidance. The SEC and FINRA have always anchored the definition of recommendation to a "call to action" analysis.[13] At the same time, the SEC and FINRA have also provided clear and specific examples of when a recommendation has been made and when it has not.[14]

It is difficult to imagine how a firm could build a supervisory system and written supervisory procedures reasonably designed to supervise against the broad phrase "*any* means, method or mechanism" (emphasis added) that "feature[s] or promote[s]" an account type, security or strategy. This is especially so given that Reg BI requires firms to focus their policies, procedures, testing, training, supervision, and other documentation premised upon a financial advisor making an actual "recommendation" of an account type, security or investment strategy (per the current, well-understood SEC and FINRA definitions and interpretive guidance). Here, the Proposal suggests a seemingly impossible standard, i.e., determining what is in a customer's best interest at the point in time that the firm is merely "featuring" or "promoting" an account type, security or strategy.

a. The proposed definition would disrupt numerous, long-standing, beneficial business practices.

Virtually all activities of a broker-dealer that involve educating or making customers aware of its product and services, whether via digital web-based channels, print or television advertising, or other channels would likely fall within the Proposal's expansive definition of a recommendation. Consider, for example, the impact of the Proposal on a firm's web-based brokerage platform. Customers often expect their broker-dealers to maintain robust and intuitive digital platforms through which they can, among other things, manage their accounts, access advice and guidance, and research the broker-dealer's products and services.

Under the Proposal's definition of a recommendation, however, even "featuring" a broker-dealer's account types, securities or strategies would constitute a "recommendation." In situations where a broker-dealer may offer different investment strategies or managed account offerings, the firm would be faced with the following difficult choices: (i) conduct a best interest analysis for each customer prior to presenting the available options (something that would likely be impossible to operationalize at scale and would insert unwarranted complexity in the basic process of customers seeking information regarding a firm's products and services), (ii) restrict the availability of this type of information, or (iii) remove the information entirely from digital platforms. Rather than advancing the goal of customer protection, the likely effect of the Proposal would be to limit customer education and access to information about a firm's account types, products and services.

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[13] Reg BI Adopting Release (***"Adopting Release"***) at pp. 79-80 and fn 164, and p. 104, https://www.sec.gov/files/rules/final/2019/34-86031.pdf.

[14] *See, e.g.*, FINRA Notice 01-23, Suitability Rule and Online Communications (Apr. 2001), https://www.finra.org/rules-guidance/notices/01-23 (providing clear and specific examples of when a recommendation has been made in the context of online brokerage). *See also* SEC FAQs on Reg BI (Jan. 2020), https://www.sec.gov/tm/faq-regulation-best-interest#recommendation (providing additional concrete examples of what constitutes a recommendation subject to Reg BI).

The same issue arises with other firm communications, mediums and tools that have never been considered recommendations under decades of SEC and FINRA guidance and rules, including without limitation:[15]

- advertising,
- marketing materials,
- social media communications,
- general financial information on the firms' and financial advisors' websites,
- proprietary investment analysis tools,
- retirement education tools,
- research reports, and
- third party tools, such as the FINRA Fund Analyzer.

Take advertising for example. Firms routinely advertise – some on a national level – to "promote an account type" (e.g., IRA accounts). Firms may offer modest financial incentives to open a new IRA account, such as $500, in that advertisement. Does that mean that when a prospective client responds to the ad and opens a new IRA account, that the ad itself becomes a "recommendation" to open that account? In order to avoid this obviously unintended consequence, should firms stop encouraging retirement savings instead? Of course not.

Firms also routinely use marketing brochures and client-facing documents and tools to educate clients about specific securities, investment strategies, and retirement planning. Longstanding SEC and FINRA guidance, however, have drawn clear distinctions between "education" and a "recommendation."[16]

The Proposal's impact on research reports is also concerning. Under today's standards, if a financial advisor proactively sends a research report to a particular client about a particular company, then that would be considered a "recommendation" to that client. If, however, the client accesses the firm's website and retrieves a research report about a company, then that would not be considered a "recommendation."

If a firm posts a research report with a "buy" rating to its website, would that be considered a "means" or "method" to "feature" a specific security under the Proposal? What about third-party research reports that are posted on the firm's website and accessible by clients? If a client accesses the report, does that convert the client's action into a "recommendation" by the firm? Each of these examples would seem to fall squarely within the Proposal's new definition of a recommendation. If so, then firms may cease developing and providing access to

[15] All of these enumerated categories of 'non-recommendation communications' are already subject to a robust, well-functioning, regulatory regime that is focused on protecting investors from the potential risks of "featuring" or "promoting" products or services. *See, e.g.*, FINRA Rule 2210 (Communications with the Public) and FINRA Rule 2241 (Research Analysts and Research Reports).

[16] Adopting Release at pp. 89 – 91 ("The treatment of certain communications as 'education' rather than 'recommendations' is well understood by broker-dealers."); FINRA Rule 2111.03; FINRA Rule 2214 on Investment Analysis Tools; FINRA Notice 11-25.

research reports to their customers, thereby depriving them of the opportunity to educate themselves about specific companies or sectors in which they may choose to invest.

Firms would face significant obstacles and costs in attempting to develop a supervisory system with respect to the myriad of activities enumerated above, assuming it was even possible to do so, if these activities are deemed to be "recommendations" under the Proposal. For all the foregoing reasons, among others, NASAA should strike its vague, overbroad, and unnecessary redefinition of "recommendation" in the Proposal.

b. The proposed definition would disrupt the self-directed brokerage business model.

The Proposal's preamble also states that the expanded definition of recommendation is in response to the SEC "updating [its] guidance" about firms' digital engagement practices (***"DEPs"***) that may rise to the level of an investment "recommendation" subject to Reg BI.[17] To our knowledge, however, the SEC is not in fact updating its guidance on recommendations, but was simply requesting comment on firms' DEPs back in August 2021.[18] Since that time, the SEC appears to have made a hard pivot towards an entirely different approach and proposal to manage conflicts of interest in firms' predictive data analytics.[19]

Notwithstanding the foregoing, the Proposal's redefinition of recommendation would encompass virtually any type, form or level of digital engagement between a firm and its retail customer, regardless of whether such communication constituted an actual investment recommendation under the existing SEC and FINRA framework. In this regard, NASAA's expanded definition appears to target the self-directed brokerage business model, which generally operates in an online environment, and is specifically designed and intended *not* to generate investment recommendations subject to Reg BI.

The new definition, however, would force the self-directed brokerage business model to collect new customer investment profile information, supervise, and essentially serve as guarantor for securities transactions that it did not recommend, and over which it has very little control. It is worth noting that today firms are not required to collect or update investment profile information for self-directed clients because no recommendations are made, and no supervision is necessary under FINRA Rule 3110 or Reg BI. The Proposal, however, would force self-directed firms to collect and update such information *in the event* that a self-directed customer receives a "recommendation" as defined in the Proposal, That, in turn, would require the firm to develop supervisory systems to address when (or if) a recommendation was actually made. These outcomes would be costly and untenable for the self-directed business model. In turn, firms would probably consider exiting the self-directed brokerage business, thereby further eroding investor choice in the investment marketplace.

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[17] Preamble to Proposal at p. 7 and fn 14.

[18] SEC Release Nos. 34-92766; IA-5833 (August 27, 2021).

[19] File No. S7-12-23; IA-6353 (July 26, 2023).

2. The Proposal's conflicts of interest provisions directly conflict with Reg BI's Conflict of Interest Obligation (Subparts 1.d.(1) and (2)).

The Proposal not only conflicts with Reg BI's Conflicts Obligation, but also fails to explain or justify why such deviation is necessary or how it would better serve and protect retail customers. For example, the Proposal asserts that disclosure alone is insufficient. Yet, the Proposal fails to offer any argument – or evidence – that disclosure is not an effective tool to mitigate potential conflicts of interest for retail customers.

a. The Proposal's "disclosure alone is insufficient" conflicts with Reg BI.

Subpart 1.d.(1) of the Proposal states: *"The obligations set forth in this section cannot be satisfied through disclosure alone."* This language directly conflicts with Reg BI. Reg BI distinguishes between (i) firm-level financial incentives (e.g., revenue sharing payments to firms from asset managers, which financial advisors do not receive and thus, which generally do not raise a potential conflict with an advisor's recommendations), and (ii) financial advisor-level financial incentives, which potentially may conflict with a financial advisor's recommendation to a retail customer. Under Reg BI, the SEC has made clear that "rather than requiring mitigation of all firm-level incentives, we have determined to refine our approach by generally *allowing firm-level conflicts to be generally addressed through disclosure*." (emphasis added).[20]

NASAA's proposed language in Subpart 1.d.(1), however, fails to acknowledge or incorporate Reg BI's requirement that generally speaking, firm-level incentive conflicts need only be disclosed, and need not be mitigated or eliminated. Accordingly, to align the Proposal's subpart 1.d.(1) with Reg. BI, NASAA should amend its language to state as follows: *"The obligations set forth in this section cannot be satisfied through disclosure alone regarding financial advisor-level financial incentives.*

b. The Proposal's "avoid or eliminate" formulation conflicts with Reg BI.

Subpart 1.d.(2) of the Proposal states:

> *"To ensure the broker-dealer or agent does not "place the financial or other interest of the broker-dealer or agent ahead of the interest of the retail customer," the broker-dealer or agent must* ***make all reasonable efforts to avoid or eliminate conflicts of interest. Conflicts of interest that cannot reasonably be avoided or eliminated must be disclosed and mitigated****."* (emphasis added).

NASAA's "avoid or eliminate" formulation with respect to conflicts of interest is inconsistent with Reg BI. Reg BI does *not* require a broker-dealer to "avoid or eliminate" conflicts related to a recommendation. Rather, at a minimum, Reg BI requires a broker-dealer to "disclose … or eliminate" all material facts related to conflicts of interest associated with a recommendation.

[20] Adopting Release at p. 328. We acknowledge, however, that if a potential conflict of interest creates an incentive for the financial advisor to place their interest ahead of the retail customer, then Reg BI further requires the firm to mitigate the potential conflict of interest. Reg BI, 17 C.F.R. § 240.15l-1(a)(2)(iii)(b).

Under Reg BI, only certain conflicts must be eliminated (i.e. sales contests, sales quotas, bonuses, and non-cash compensation, that are based on the sales of specific securities within a limited period of time).[21] With respect to conflicts associated with a recommendation that create an incentive for a financial advisor to place his or her interest ahead of the retail customer's interest, Reg BI requires broker-dealers to "identify and mitigate" such conflicts.

The Proposal's Subparts 1.d.(1) and (2) would require firms to essentially avoid or eliminate all conflicts in order to comply, rather than be second-guessed by regulators as to whether they made *"all reasonable efforts to avoid or eliminate"* such conflicts. Firms would simply eliminate whatever products or services they offer that raise either a potential firm-level and/or financial advisor-level financial incentive. This approach, however, would lead to less investor choice among brokerage products and services, and may require the client to move to a fee-based investment advisory account in order to receive the same product or service that the client previously held in brokerage. Eliminating products would negatively impact retail customers where, for example, the product is illiquid or subject to tax or other cost consequences. Migrating to fee-based accounts would negatively impact retail customers where a brokerage account is the optimal, most cost effective vehicle for a particular product (e.g., a bond ladder). The balance struck in Reg BI's Conflict of Interest Obligation was specifically designed to avoid these types of negative consequences, and to maximize investor choice and access to financial products, services, and account types.

As an example, many insurance affiliated broker-dealers distribute their own proprietary life and annuity products and both the broker-dealer and affiliated issuer are compensated for sales. Reg BI permits the recommendation of such proprietary products with appropriate disclosure and conflict management. These proprietary products may be in a customer's best interest because, among other things, the firm can better control compensation conflicts, and the firm is more knowledgeable about the product's features and suitability for particular customers. Under the Proposal, however, it would be impossible to "avoid or eliminate" the potential conflict of interest inherent in these products, other than by eliminating the products from brokerage accounts, which would significantly undermine customer choice and access.[22]

3. The Proposal's "cash or non-cash compensation" provision conflicts with Reg BI (Subpart 1.d.(2)b.).

Subpart 1.d.(2)b. of the Proposal states:

"The broker-dealer or agent will be presumed to have placed its financial interest ahead of the interest of the retail customer where the broker-dealer or agent participates in (i) sales contests; (ii) sales quotas; (iii) bonuses; or (iv) any other non-cash compensation that are based on the sales of specific securities or

[21] Adopting Release at pp. 319-320 and 347.

[22] This outcome would be contrary to the SEC's goal in enacting Reg BI. *See id.* at pp. 326-27 ("We are persuaded by commenters that expressed concern that requiring broker-dealers to establish policies and procedures reasonably designed to mitigate all financial incentives, including any compensation, may result in broker-dealers narrowing their product shelf and compensation practices which would be inconsistent with the [SEC's] stated goal.").

> *specific types of securities within a limited period of time**, or rewards the broker-dealer or agent with additional cash or non-cash compensation beyond the sales commission as the result of that recommendation**." (emphasis added).*

The new bold italicized language above directly conflicts with not only Reg BI's regulatory requirements, but also Reg BI's overall compensation framework, which is designed to, and in fact does, promote retail investors' access to products, services, and best interest investment advice. This new provision would create a rebuttable presumption that the broker-dealer is placing its financial interest ahead of the customer if the broker-dealer receives *any* compensation beyond basic sales commissions.

By going beyond the requirements of Reg BI and creating a presumption of non-compliance, the Proposal would effectively prohibit broad categories of variable compensation programs which are otherwise structured to comply with Reg BI.[23] For example, a firm that compensates representatives, in part, based on aggregate net flows of assets into customer accounts would need to overcome a presumption that this form of product-neutral compensation somehow presents a conflict of interest. In addition, firms would need different compensation models for the states that have adopted different versions (or no version) of the Proposal thereby making compensation disclosure highly confusing and most likely incomprehensible to customers.

Recruiting agreements – where compensation is paid over a period of time for the recruited adviser to bring in the assets of their former customers (i.e., recommendations to transfer assets) – are another example of compensation beyond commissions. These recruiting deals are standard in the industry and are already subject to FINRA regulation.[24] The Proposal, however, would create a rebuttable presumption that it is a dishonest and unethical practice for a recruited adviser to recommend to a former customer to transfer assets to the new firm (when it is in the customer's best interest to do so), if the recruited advisor receives additional compensation for that recommendation that is not derived from commissions.

The Proposal's new language would extend a provision of Reg BI that was narrowly focused on eliminating specific types of compensation (i.e., sales contests, sales quotas, and the like) and apply it to other forms of standard industry compensation, including bank sweep programs (where affiliated banks earn revenue), payment for order flow, third party non-cash compensation used for adviser training and education, deferred compensation programs, loyalty bonuses, internal referral programs, and expense allowances earned as part of a title promotion, among others.

As another example, many insurance affiliated broker-dealers distribute their products through agents who are statutory employees under the federal tax code. Under the federal tax code, firms are permitted to provide health and welfare benefits to these agents, provided that

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[23] In addition, for certain international firms, the Proposal would likely interfere with their uniform compensation plans across the enterprise causing additional customer confusion, significant compliance challenges, and potentially disparate compensation outcomes for financial advisor-employees.

[24] FINRA Rule 2273 (Educational Communication Related to Recruitment Practices and Account Transfers).

they meet certain annual sales/production requirements. The SEC acknowledged that Reg BI does "not intend to prohibit the receipt of certain employee benefits" including healthcare and retirement benefits to statutory employees.[25] The Proposal, however, would place these sales requirements in its crosshairs and risk the loss of agents' health and welfare benefits, which would represent a major public policy failure.

The Proposal's preamble labels many of these forms of compensation as "manufactured conflicts" that are gratuitously injected into transactions purely to drive sales. The preamble further asserts that these compensation conflicts are "layered" upon each other in a manner that "exacerbates … the potential for customer harm." Finally, the preamble strongly suggests that such compensation conflicts would be best handled by avoiding or eliminating such conflicts.[26] Nowhere in the Proposal, however, does NASAA explain why it is necessary to deem *any* "cash or non-cash compensation" beyond the sales commission received from a recommendation as being presumptively in violation of a firm's obligation to its customer.

If not avoided or eliminated, then "firms [would] need to rebut the presumption that they are placing their financial interests ahead of their customers" when they receive "these extra forms of compensation."[27] It is unclear how a firm would "rebut" the presumption. What standard would apply? Would it differ from state to state, and among different compensation types? This provision is unreasonably vague and subject to arbitrary application, inconsistent with Reg BI, and should be stricken.

II. The Proposal also conflicts with numerous other provisions of Reg BI.

In addition to the three major respects discussed above, numerous other provisions in the Proposal also conflict with Reg BI.

1. The Proposal's customer investment profile information exceeds that required under Reg BI (Subparts 1.d.(3)a.3. and 1.d.(3)a.4.).

Subpart 1.d.(3)a.3. adds *"education"* and *"debt"* to the customer investment profile information that must be considered in making a best interest recommendation. The SEC does not include either of these two factors in the definition of customer investment profile information under Reg BI.[28] NASAA otherwise duplicates the SEC list in Subpart 1.d.(3)a.3. and offers no rationale or explanation for expanding it. Accordingly, the NASAA list should be conformed to the SEC list.

As for education, why is a college degree, or law degree, or PhD even relevant, unless it directly relates to a certain level of financial knowledge, experience, and expertise, which it typically does not? As for debt, it tends to come and go; how would firms monitor a client's debt

[25] Adopting Release at p. 356.

[26] Preamble to Proposal at p. 4.

[27] *Id.* at p. 5.

[28] Adopting Release at pp. 273 – 275.

levels, when there is no duty to monitor accounts under Reg BI? Would it be inappropriate to give investment advice to a client with high debt and if so, why?

Moreover, firms already capture client debt under SEC Regulation 17a-3, which requires firms to gather net worth information for each account with a natural person as owner. Since net worth is defined as assets (excluding primary residence) minus liabilities (i.e., debt), firms already have a general understanding of the impact of debt on the client's overall financial picture. Thus, requiring firms to separately collect this information would be redundant.

As a practical matter, expanding the profile information to include education and debt would require firms to repaper all of their client accounts to collect this new information, and to modify their account opening and other systems of record to include these two new categories. Doing so would be costly, time consuming and require additional technology resources. Moreover, it is far from clear that this new information would improve investment advice.

For all the foregoing reasons, education and debt should be stricken as new elements of customer investment profile information under the Proposal.

Subpart 1.d.(3)a.4. also includes the catch-all phrase *"any other relevant information"* as part of the customer investment profile information that must be considered in making a recommendation. Again, Reg BI's catch-all is considerably narrower: "and any other *information the retail customer may disclose to the [firm or an associated persons]* in connection with a recommendation." (emphasis added).[29] It would be neither fair nor appropriate to hold broker-dealers to a standard of considering *any other* relevant information, particularly where the customer did not disclose it, and the broker-dealer is otherwise unaware of such information. Accordingly, NASAA's catch all phrase should be conformed to Reg BI's.

2. The Proposal's misstates the obligation to review "reasonably available alternatives" under Reg BI (Subpart 1.d.(3)b.).

Subpart 1.d.(3)b. states: *"To satisfy this care obligation, a broker-dealer or agent shall make reasonable inquiry regarding lower-cost and lower-risk securities and investment strategies that are reasonably available to the broker-dealer or agent, as well as products or services available if the agent is also [licensed/registered] in other capacities such as an investment adviser representative or insurance agent."*

The foregoing statement appears to misstate the obligation to review reasonably available alternatives under Reg BI. Under Reg BI, firms are required to consider reasonably available alternatives approved for sale through their firm based on information reasonably known to the relevant associated person after exercising reasonably diligent search strategies. This balancing reflects the recognition that producing recommendations entails cost, while also protecting the interests of the investor and putting them first.

[29] *Id.* at pp. 273-75. *Accord* FINRA Rule 2111 (Suitability), https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111.

The Proposal, however, appears to suggest a vague obligation to review all options, whether offered at the firm *or outside the firm*, which is inconsistent with Reg BI. The SEC has made clear, however, that "a broker-dealer does not have to conduct an evaluation of every possible alternative, either offered outside of the firm (such as where the firm offers only proprietary products or other limited range of products) or available on the firm's platform."[30] The SEC also acknowledges that an obligation to "review all options" would be impractical and potentially impossible. The Proposal provides no rational basis for abandoning the SEC's sound policy choices.

In addition, with respect to a financial advisor who is also licensed as an insurance agent, we question what regulatory authority a state securities regulator would have to compel such financial advisor to consider non-securities insurance products before making an investment recommendation.[31] Finally, the requirement to consider "lower-cost and lower-risk" alternatives seems to suggest that certain higher cost and/or higher risk products (e.g., complex products) could not be recommended as in the client's best interest, when in fact they may well be.

3. The Proposal's treatment of "costs" is inconsistent with Reg BI (Subpart 1.d.(4)).

Subpart 1.d.(4) states:

> *"For purposes of this subsection, "costs" include the sum total of all potential fees and costs based on the anticipated holding period for the security or investment strategy that is recommended by the broker-dealer or agent. a. "Costs" include but are not limited to account fees, commissions, other transactional costs such as markups and markdowns, costs arising from tax considerations,* ***costs associated with payment for order flow and cash sweep programs****, and other indirect costs that could be borne by the retail customer. b. When applicable, "costs" also include fees associated with the investment products that are available through the account, such as* ***the internal expenses of funds, management fees, distribution and servicing fees, including any front-end and back-end fees****. c. To the extent that certain "costs," such as distribution and servicing fees and transactional costs, depend on the retail customer's anticipated investment horizon, the broker-dealer or agent is to consider the potential impact of those costs on the customer's account based on an understanding of that horizon."* (emphasis added)

NASAA asserts that this provision is simply codifying SEC staff guidance (which, as discussed in Part VI below, would be inappropriate), but nowhere does the SEC require firms to consider the "sum total of all potential fees and costs based on the anticipated holding period for the security or investment strategy," as well as the litany of costs set forth in sub-sections (a), (b)

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[30] *Id.* at p. 284. "The Conflict of Interest Obligation addresses limited product menus by requiring that broker-dealers take measures through reasonably designed written policies and procedures to evaluate and prevent the limitations and the associated conflicts of interest from causing associated persons of the broker-dealer to make recommendations that are inconsistent with the requirements of [Reg BI.]" *Id.* at 597.

[31] To our understanding, NASAA's current broker-dealer model rule, and the Proposal's potential revisions thereto, apply only to recommendations of products deemed to be "securities" under state law.

and (c). As a practical matter, it would be virtually impossible for a firm or financial advisor to perform this sort of transaction-level analysis.

To estimate the "sum total of all potential fees and costs" would require the broker-dealer to make a variety of assumptions regarding the holding period, market performance, how the security or investment strategy performs during that period, changes in asset allocation, how the individual investor's financial goals or tax profile changes throughout the holding period, and macro-economic conditions, among other factors. Given the variety of assumptions and the interdependency among those assumptions, any such estimate may in fact be inaccurate and/or misleading. Even if such analysis could be done, the process would be costly, time consuming and difficult to operationalize. If implemented, the recommendation making process would grind to a halt, resulting in lost opportunities and less choice for investors.

Moreover, many of these costs/payments represent firm-level compensation, not financial advisor-level or point-of-sale costs. As discussed above, financial advisors do not generally share in these revenues so the potential conflict does not exist in connection with the investment recommendation. With respect to payments for order flow (PFOF) and cash sweep payments, these arrangements change all the time. These types of payments are disclosed to customers in general terms, but it would be impossible to predict or disclose the ultimate cost to the investor at the time the investment recommendation was made.

4. The Proposal's definition of "retail customer" is inconsistent with Reg BI (Subpart 1.d.(6)).

Subpart 1(d)(6) states that the term "*'retail customer' shall include current and prospective customers, and clients, but shall not include*" (a list of institutional entities). This definition differs from the definition of retail customer in Reg BI.[32] NASAA offered no rationale or explanation for deviating from the Reg BI definition.

Moreover, all firms' systems, reporting, processes, and documentation are built upon who falls within the definition of "retail customer" as defined in Reg BI. Firms could not reasonably be expected to incorporate and systematize different definitions in different jurisdictions. Finally, the Proposal's expansion of the definition of retail customer to explicitly include prospects, coupled with the expanded definition of a recommendation (as discussed above), would effectively prevent broker-dealers from educating the public about their products and services through their website, advertising, or any other "means, method or mechanism" for that matter. Accordingly, the NASAA definition of "retail customer" should be conformed to the Reg BI definition.

5. The Proposal's titling provision conflicts with Reg BI (Subpart 1.e.).

Revision #3 to the Proposal adds Subpart 1.e., which would make the following a violation of broker-dealer conduct standards: "*Using a title, purported credential, or professional designation containing any variant of the terms "adviser" or "advisor" without*

[32] Reg BI, 17 C.F.R. § 240.15l-1(b)(1).

licensure as either an investment adviser or an investment adviser representative, unless otherwise permitted by law."

This provision would prohibit use of the term "advisor" or "adviser" unless the individual is licensed as an investment adviser or investment adviser representative. This provision is narrower than Reg BI, which also permits individuals who are supervised persons (i.e., employees) of an investment advisor to use the title "advisor" or "adviser."[33] The Proposal would require financial advisors who do not have an advisory license to use a different title, in conflict with Reg BI.

III. The Proposal conflicts with the NAIC Best Interest Model Rule.

To date, forty states have adopted the NAIC Best Interest Model Rule.[34] The NAIC model rule incorporates a best interest standard of conduct governing the sales of annuities and includes a "safe harbor" provision for compliance with Reg BI.[35] The safe harbor ensures that the NAIC model rule remains consistent with Reg BI.

The NASAA model rule contemplated by the Proposal, however, would not only conflict with Reg BI, but also conflict with the NAIC model rule. As a result, in a state that has adopted both the NAIC model rule and the proposed NASAA model rule, sales of variable annuities would be required to comply with three different regulations: Reg BI, the NAIC rule, and the NASAA rule. Although there is no compliance conflict between Reg BI and the NAIC rule, the introduction of the new NASAA rule would create a compliance quandary for firms with respect to the other two regulations.

Intrastate regulatory conflicts would also abound. A State Insurance Commissioner who asserted jurisdiction over variable annuities would rely on the NAIC model rule, while the State Securities Division would rely on the different and conflicting requirements of the new NASAA model rule for sales of that same security. This situation would present a direct conflict between the state's regulatory authorities over the appropriate rule to apply to the sale of variable annuities. NASAA should avoid this result, for example, by including a safe harbor substantially similar to the NAIC model rule safe harbor in the new NASAA model rule.

IV. The majority of the Proposal is unnecessary.

For states to incorporate Reg BI and related SEC staff guidance on Reg BI, all that is required is Revision #1, which adds new Section 1.d., to the Proposal. Indeed, that is essentially the approach that Ohio took in 2021 to incorporate Reg BI into its regulations. In the Proposal, NASAA acknowledges that it modeled its new Section 1.d. language after Ohio's. Nothing further is required to incorporate Reg BI.

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[33] Adopting Release at pp. 157 – 158.

[34] *See* https://content.naic.org/cipr-topics/annuity-suitability-best-interest-standard.

[35] *See* NAIC Best Interest Model Rule at Section 6.E., https://content.naic.org/sites/default/files/inline-files/MDL-275.pdf.

Notwithstanding the foregoing, the following additional, bold, underlined edits to Section 1.d. of the Proposal are necessary in order to properly align it with the language and requirements of Reg BI:

> When making a recommendation **of any securities transaction or investment strategy involving securities (including account recommendations)** to a retail customer, placing the financial or other interest of the broker-dealer, or ~~agent~~**natural person who is an associated person of a broker-dealer making the recommendation,** ahead of the interest of the retail customer, recommending an investment strategy involving securities (including account recommendations) or the sale or purchase of any security without a reasonable basis to believe that the recommendation is in the best interest of the retail customer **at the time the recommendation is made** based on the customer's investment profile and the potential risks, rewards, and costs associated with the recommendation, or otherwise failing to comply with the obligations set forth in Regulation Best Interest, as set forth in rule 17 C.F.R. § 240.15l-1, including, but not limited to 17 C.F.R. § 240.17a-14.[36]

V. The Proposal would create a patchwork of inconsistent regulations among states.

As shown below, in its attempt to define or clarify various obligations under Reg BI, the Revision #2 subparts in many places expand upon or differ from Reg BI's requirements, in certain cases, rewriting specific obligations (i.e., the Conflicts Obligation), or redefining key terms (i.e., "recommendation"). This defect is compounded by NASAA's invitation for states to treat the subparts as a "menu" from which states can choose to adopt "one, some, or all" of the subparts.[37] The likely result will be an uneven patchwork of different regulations with different standards among the fifty states.

A state-by-state approach runs a significant risk of imposing regulations that are sufficiently costly, burdensome and difficult to implement such that firms may be incentivized to:

- recommend clients who still want access to advice to consider moving their brokerage accounts to fee-based accounts (assuming it is in the client's best interest to do so); though clients may choose to do so, it may ultimately be more costly for certain investors;
- discontinue service to brokerage accounts altogether;
- discontinue service to self-directed brokerage accounts in states that adopt the proposed changes to the model rule;

[36] Reg BI, 17 C.F.R. § 240.15l-1(a).

[37] Preamble to Proposal, at p. 3

- discontinue service in states where the regulatory framework cannot practicably be supported operationally;
- limit the availability of certain products and/or services;
- eliminate or substantially restrict the availability of information about a broker-dealer's products and services; and/or
- raise prices to cover their higher costs.

The corresponding negative impacts to retail customers may include greater cost, less choice,[38] and confusion over what "best interest" standard they are owed in any given state.

NASAA would be remiss if it did not carefully consider the foregoing, prospective negative impacts on retail customers; carefully weigh those impacts against the anticipated benefits of the Proposal's new rule language (which NASAA has yet to articulate); and share their analysis with the public, in writing, in connection with a re-proposal of the Proposal.

VI. The Proposal inappropriately proposes to incorporate SEC staff guidance into a new model rule for adoption by various states.

NASAA states that the eight new subparts added to Revision #2 are intended to incorporate in the model rule Reg BI guidance that appears in various, recent SEC staff bulletins and the original Adopting Release (but that is not expressly included in the text of Reg BI).[39] The Proposal, however, fails to acknowledge or address the SEC staff's own explicit limitation that an SEC staff bulletin or statement is "not a rule, regulation or statement of the [SEC]" and "like all staff statements, has no legal force or effect: It does not alter or amend applicable law, and it creates no new or additional obligations for any person."[40]

SEC staff bulletins represent interpretations and policies followed by the SEC staff on any given matter. For firms, these bulletins may be viewed essentially as best practices that provide a degree of flexibility and discretion to implement in a bespoke manner for each individual firm. By proposing to incorporate the Reg BI guidance directly into the model rule text, NASAA would be unnecessarily depriving firms of that very flexibility and discretion.

Finally, if the SEC were to attempt to incorporate guidance from a SEC staff bulletin into the text of Reg BI itself, then the SEC would be required to comply with the full range of Administrative Procedure Act notice and comment rulemaking requirements, including robust

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[38] As the SEC stated in the Reg BI Adopting Release, "there is broad acknowledgement of, and support for, the broker-dealer business model, including a commission or other transaction-based compensation structure." With respect to the advisory and brokerage business models, the SEC added, "[t]his variety is important because it presents investors with choices regarding the types of relationships they can have, the services they can receive, and how they can pay for those services."

[39] Preamble to Proposal at p. 3. With respect to the language in the Reg BI Adopting Release, we acknowledge that it represents the views of the SEC and thus informs Reg BI. Accordingly, we generally do not object to NASAA's references to the Adopting Release to the extent that NASAA does not include its own interpretive gloss.

[40] This same language appears, virtually verbatim, in every SEC staff bulletin. *See e.g.*, SEC Staff Bulletin: "Standards of Conduct for Broker Dealers and Investment Advisers Account Recommendations for Retail Investors" at fn 1, https://www.sec.gov/tm/iabd-staff-bulletin.

cost-benefit analysis. The SEC has chosen not to do so. Accordingly, it would be inappropriate for NASAA to supplant the role of the SEC, incorporate SEC staff guidance that has "no legal force or effect" into a model rule, and attempt a back-door amendment to the text of Reg BI.

* * *

If you have any questions or would like to further discuss these issues, please contact the undersigned at 202-962-7300. With respect to questions regarding Appendix 2, please contact A. Valerie Mirko, Armstrong Teasdale LLP, at vmirko@atllp.com.

Sincerely,

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cc: Haoxiang Zhu, Director, Division of Trading and Markets, SEC
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Appendix 1

The Proposal is in large part federally preempted.

1. The Proposal's NSMIA savings clause does not preclude NSMIA preemption of the Proposal, (Subpart 1.d.(8)).

Subpart 1(d)(8) states that *"Nothing in this section shall be construed to establish any requirements for capital, custody, margin, financial responsibility, making and keeping of records, bonding, or financial or operational reporting for any broker dealer or agent that differ from, or are in addition to, the requirements established under 15 U.S.C. § 78o(i)."*

Subpart 1(d)(8) appropriately recognizes that the National Securities Market Improvement Act (***"NSMIA"***)[41] preempts state securities regulators from, among other things, creating new recordkeeping requirements that differ from, or are in addition to, the requirements under the federal securities laws.

NSMIA not only limits state regulations that *directly* impose new or different recordkeeping requirements, but also state regulations that by their nature require BDs to make and keep new or different records than those required by federal law and FINRA rules.[42] Thus, any state regulation that imposes new or different standard of conduct requirements on BDs, including those subparts in the Proposal (discussed above) that conflict with Reg BI, which would require new supervision obligations or compliance procedures, etc., would in turn trigger new or different record-keeping obligations, which would in turn be subject to express federal preemption under NSMIA.

For example, firms would be required to create customer investment profile records for self-directed retail customers, given the Proposal's new definition of "unsolicited transaction." Firms would also be required to create new customer investment profile records for retail customers that they advise, given the Proposal's new definition of "customer investment profile." In each case, the Proposal's definitions conflict with Reg BI, imposes new recordkeeping requirements, and thus would be preempted under NSMIA.

Although the Proposal states that "[n]othing in this section shall be construed to establish any requirements for … making and keeping of records," this provision does not relieve any state regulator of, or legally insulate it from, its obligation to avoid imposing, directly or indirectly, NSMIA-preempted books and records requirements. As currently drafted, the Proposal cannot be reconciled with NSMIA and therefore, if enacted by any state, would be unlikely to survive a legal challenge on NSMIA grounds.

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[41] 15 U.S.C. § 78o(i)(1) ("No law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall establish . . . making and keeping records . . . requirements for brokers, dealers, municipal securities dealers, government securities brokers, or government securities dealers that differ from, or are in addition to, the requirements in those areas established under this chapter.").

[42] *See* Exchange Act Rule 17(a)-4, requiring broker-dealers to keep a record of *"all communications … by the member … relating to its business as such…"* (emphasis added). 17 CFR §§ 240.17a-4(b)(4).

2. The Proposal is likewise preempted by Reg BI.

As the SEC explained, "the preemptive effect of [Reg BI] on any state law governing the relationship between regulated entities and their customers would be determined in future judicial proceedings based on the specific language and effect of that state law."[43]

As detailed in Part I. above, the Proposal directly conflicts with Reg BI in three major respects:

- the redefinition of what constitutes a "recommendation"
- the rewriting of the Conflict of Interest Obligation under Reg BI; and
- The treatment of "cash and non-cash compensation."

As detailed in Part II. above, the Proposal also directly conflicts with Reg BI in five other respects:

- the expansion of customer profile information;
- the misstatement of the "reasonably available alternatives" obligation;
- the treatment of "costs;"
- the inconsistent definition of "retail customer;" and
- the titling provision.

Based upon the foregoing enumerated provisions which would essentially rewrite major portions of, and directly conflict with, Reg BI, a court would likely find that the Proposal is preempted by Reg BI.

[43] Adopting Release at p. 43 and p. 514, fn 1163.

Appendix 2
Comparison Chart: NASAA Proposed Model Rule and Reg BI[44]

Row # | Proposed Rule and Relevant Excerpts of the Proposal	Reg BI and Reg BI Release	Recent Reg BI Guidance, including Reg BI FAQ and Staff Bulletins	Commentary
1. Revision Set #1 (The Proposed Standards Generally) **Release Text (on Part 1.d.):** The first proposed revision to the Business Practices Rule – acknowledgement and incorporation of the principles in Reg BI – would be inserted as new Part 1d, placed immediately after the prohibition against unsuitable recommendations. . . . The text in Part 1d is similar to language adopted in Ohio in 2021 to update its state regulations in light of Reg BI.[45]	n/a	n/a	The Proposed Rule creates a new business practice standard[46] that consists of three main components: 1. The Proposed Rule's Conflicts Obligation (see Row 3: "*Revision Set #1 (The Proposed Rule's Conflicts Obligation)*"); 2. The Proposed Rule's Care Obligation (see Row 4: "*Revision Set #1 (The Proposed Rule's Care Obligation)*"); and 3. Incorporation of the lack of compliance with SEC Reg BI (see Row 5: "*Revision Set #1 (The Proposal's Incorporation of Lack of Compliance with Reg BI)*"). The Proposal is divided into three Revision Sets. Revision Set #1 sets forth the three components of the new business practice standard listed above. Revision Set #2 modifies and expands on the new business practice standard set forth in Revision Set #1. Finally, Revision Set #3 addresses the use of certain titles and terms. This Appendix addresses the Revision Sets in the order set forth in the Proposal.
2. Revision Set #1 (Definition of Recommendation) **Proposed Rule Text (Part 1.d.):** d. When making a recommendation to a retail customer, . . . **Also includes Existing Rule Text (Part 1.c.):**	**§ 240.15*l*–1(a)(1)** (a) *Best interest obligation.* (1) A broker, dealer, or a natural person who is an associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer, . . .	n/a	The Proposed Rule would expansively apply to all recommendations to retail customers. In contrast, Reg BI applies solely "when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer." As currently drafted, the Proposed Rule's expansive language regarding recommendations is not applied uniformly within the

[44] As used in this Appendix, the term "***Proposed Rule***" refers exclusively to the additions to the text of the rule included on Exhibit A to the Proposal, rather than the quotations set forth in the body of the Proposal. There are inconsistencies between the language included in the Proposed Rule's text from the body of the Proposal and the corresponding text on Exhibit A of the Proposal (e.g., the exclusion of quotations in Subpart 1.d.(2) and the exclusion of the emphasized text in Subpart 1.d.(2)b.(iv): "any other non-cash compensation *that are* based on . . .").

For purposes of this Appendix, footnotes are omitted from quoted text.

[45] The Proposal's statement of the proposed business practice standard in Part 1.d. generally follows the same approach as the Ohio Administrative Code (*see* Ohio Admin. Code § 1301:6-3-19(A)(6): "Place the financial or other interest of the dealer or salesperson ahead of the interest of the retail customer, recommend the sale or purchase of any security without a reasonable basis to believe that the recommendation is in the best interest of the retail customer based on the customers investment profile and the potential risks, rewards, and costs associated with the recommendation, or otherwise fail to comply with the obligations set forth in "Regulation Best Interest," as set forth in rule 17 C.F.R. 240.15l-1;").

[46] Note that "business practice standard" is term that appears in state statutes and regulations, as well as NASAA model rules.

Row # | Proposed Rule and Relevant Excerpts of the Proposal	Reg BI and Reg BI Release	Recent Reg BI Guidance, including Reg BI FAQ and Staff Bulletins	Commentary
Recommending to a customer the purchase, sale or exchange of any security without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the broker-dealer; (emphasis added.)	**Reg BI Release (p. 33335):** We believed that by applying Regulation Best Interest to a "recommendation," as that term is currently interpreted under broker-dealer regulation, we would make clear when the obligation applied and would maintain efficiencies for broker-dealers that have already established infrastructures to comply with suitability obligations, which are recommendation-based.		Proposed Rule's Conflicts Obligation and the Proposed Rule's Care Obligation: 1. The Proposed Rule's Conflicts Obligation maintains the expansive language regarding recommendations noted above and would apply to all recommendations where the financial and other interest of the broker-dealer or agent are placed ahead of the interest of the retail customer. 2. The Proposed Rule's Care Obligation limits recommendations to investment strategies or the sale or purchase of any security. 3. However, the changes to the definition of "recommendation" in Subpart 1.d.(5) purport to apply to "all of the foregoing obligations set forth in this subsection." Therefore, non-securities recommendations could violate the Proposed Rule's Conflicts Obligation, whereas non-securities recommendations are beyond the scope of Reg BI and would not result in lack of compliance with Reg BI. As described in the Reg BI Release, the SEC's intent was to align the recommendation-based approach to the suitability infrastructure. The existing rule text that the Proposed Rule seeks to modify applies the suitability standard when "recommending . . . the purchase, sale or exchange of any security." The Proposal declines to follow this approach but leaves the suitability requirement in Subpart 1.c. of the business practices rule untouched. See Row 16 regarding "*Revision Set #2 (Recommendations and Unsolicited Transactions)*" for additional discussion regarding changes to recommendation and Row 17 regarding "*Revision Set #2 (Retail Customer)*" for additional discussion regarding changes to retail customer. **Note on Timing of the Proposed Rule's Obligations:** The Proposed Rule cannot mandate a policies and procedures framework because of Exchange Act preemption. In practice, Reg BI—particularly the Reg BI conflict of interest obligation—relies on robust policies and procedures, which, in turn, mandate evaluation of conflicts on a periodic basis, but not on a recommendation-by-recommendation basis. In contrast, the Proposed Rule's Conflicts Obligation implies *application each time a recommendation is made.*

Row # | Proposed Rule and Relevant Excerpts of the Proposal	Reg BI and Reg BI Release	Recent Reg BI Guidance, including Reg BI FAQ and Staff Bulletins	Commentary
3. <u>Revision Set #1 (The Proposed Rule's Conflicts Obligation)</u> **Proposed Rule Text (Part 1.d. continued):** . . . placing the financial or other interest of the broker-dealer or agent ahead of the interest of the retail customer, . . .	**§ 240.15*l*–1(a)(1):** (a) *Best interest obligation.* (1) A broker, dealer, or a natural person who is an associated person of a broker or dealer, when making a recommendation of any securities transaction or investment strategy involving securities (including account recommendations) to a retail customer, shall act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.	n/a	<u>Both Reg BI and the Proposed Rule apply when "placing the financial or other interest of" the broker-dealer "ahead of the interest of the retail customer," however the breadth of application under the Proposed Rule is broader than under Reg BI.</u> The obligation to "place the financial or other interest of the broker-dealer or agent ahead of the interest of the retail customer" in Part 1.d. of the Proposed Rule (the "***Proposed Rule's Conflicts Obligation***"): 1. Applies broadly to all "recommendations," as redefined by the Proposed Rule;[47] 2. Prioritizes and requires all reasonable efforts to avoid or eliminate conflicts rather than mitigate conflicts;[48] 3. Where conflicts are not avoided or eliminated, mandates mitigation[49] and requires expansive disclosure of conflicts of interest;[50] 4. Contains a presumption against the receipt of non-commission compensation streams of broker-dealers, including "additional cash or non-cash compensation beyond the sales commission as the result of that recommendation";[51] and 5. Is otherwise modified by the expansions to the definitions of "retail customer" and "recommendations" and the other provisions of the Proposed Rule.
4. <u>Revision Set #1 (The Proposed Rule's Care Obligation)</u> **Proposed Rule Text (Part 1.d. continued):** . . . recommending an investment strategy or the sale or purchase of any security without a reasonable basis to believe that the	**§ 240.15*l*–1(a)(2)(ii):** (ii) *Care obligation.* The broker, dealer, or natural person who is an associated person of a broker or dealer, in making the recommendation, exercises reasonable diligence, care, and skill to: (A) Understand the potential risks, rewards, and costs associated with the recommendation, and have a reasonable	n/a	<u>The second component of the Proposed Rule (which we refer to as the "***Proposed Rule's Care Obligation***") closely follows the language in one specific subclause of the care obligation of Reg BI, § 240.15l–1(a)(2)(ii)(B), also sometimes referred to as the customer specific prong.</u> However, in contrast to Reg BI, the Proposed Rule's Care Obligation:

[47] *See* Row 2 regarding "*Revision Set #1 (Definition of Recommendation)*" and Row 16 regarding "*Revision Set #2 (Recommendations and Unsolicited Transactions)*."

[48] *See* Row 8 regarding "*Revision Set #2 (Elimination of Conflicts of Interest)*."

[49] *See* Row 10 regarding "*Revision Set #2 (Mitigation of Conflicts of Interest)*."

[50] *See* Row 9 regarding "*Revision Set #2 (Disclosure of Conflicts of Interest)*."

[51] *See* Row 11 regarding "*Revision Set #2 (Presumption of Impermissible Conflict of Interest)*."

Row # | Proposed Rule and Relevant Excerpts of the Proposal	Reg BI and Reg BI Release	Recent Reg BI Guidance, including Reg BI FAQ and Staff Bulletins	Commentary
recommendation is in the best interest of the retail customer based on the customer's investment profile and the potential risks, rewards, and costs associated with the recommendation, or . . .	basis to believe that the recommendation could be in the best interest of at least some retail customers; (B) Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation and does not place the financial or other interest of the broker, dealer, or such natural person ahead of the interest of the retail customer; (C) Have a reasonable basis to believe that a series of recommended transactions, even if in the retail customer's best interest when viewed in isolation, is not excessive and is in the retail customer's best interest when taken together in light of the retail customer's investment profile and does not place the financial or other interest of the broker, dealer, or such natural person making the series of recommendations ahead of the interest of the retail customer.		1. Replaces Reg BI's obligation to "exercise reasonable diligence, care, and skill" with a standard based on "the care, skill and diligence that a person acting in a like capacity and familiar with such matters would use, taking into consideration all of the facts and circumstances[;]"[52] 2. Includes a more exhaustive list of facts and circumstances beyond Reg BI's retail customer investment profile;[53] 3. Requires a "reasonable inquiry" of certain alternatives;[54] 4. Includes new categories for, and a new calculation of, "costs" to be considered;[55] and 5. Is otherwise modified by the changes to retail customer, recommendations and the other provisions of the Proposed Rule. It is also noteworthy that the Proposed Rule text addresses the concept of due diligence less than Reg BI's reasonable basis prong,[56] further contributing to lack of alignment between the Proposed Rule and Reg BI.
5. <u>Revision Set #1 (The Proposal's Incorporation of Lack of Compliance with Reg BI)</u> **Proposed Rule Text (Part 1.d. continued):** . . .otherwise failing to comply with the obligations set forth in Regulation Best Interest, as set	n/a	n/a	<u>The Proposed Rule incorporates *failures to comply* with Reg BI but does not directly incorporate Reg BI.</u> Instead, the Proposed Rule includes two additional obligations: the Proposed Rule's Care Obligation and the Proposed Rule's Conflicts Obligation.

[52] *See* Row 12 regarding "*Revision Set #2 (Standard for Proposed Rule's Care Obligation)*."

[53] *See* Row 13 regarding "*Revision Set #2 (Proposed Rule's Care Obligation – Relevant Facts and Circumstances)*."

[54] *See* Row 14 regarding "*Revision Set #2 (Proposed Rule's Care Obligation – Reasonable Inquiries)*."

[55] *See* Row 15 regarding "*Revision Set #2 (Proposed Rule's Care Obligation – Costs)*."

[56] *See* § 240.15*l*–1(a)(2)(ii)(A).

Row # | Proposed Rule and Relevant Excerpts of the Proposal	Reg BI and Reg BI Release	Recent Reg BI Guidance, including Reg BI FAQ and Staff Bulletins	Commentary
forth in rule 17 C.F.R. § 240.15*l*-1, including, but not limited to 17 C.F.R. § 240.17a-14.			
6. <u>Revision Set #2 (Menu Approach)</u> **Release Text:** It is important to note that the various subparts within the second revision are presented as a menu of provisions that NASAA members can use to define, clarify, or emphasize the obligations and components of Reg BI that matter most to each jurisdiction. Members may desire definition and clarity that is best achieved by adopting one, some, or all of the subparts set forth in this revision set. This approach provides flexibility while also promoting uniformity through standardized options. Each of these eight subparts is discussed separately below.	**Reg BI Release (p. 33322):** The standard also provides specific requirements to address certain aspects of the relationships between broker-dealers and their retail customers, including certain conflicts related to compensation of associated persons. We have declined to subject broker-dealers to a wholesale and complete application of the existing fiduciary standard under the Advisers Act because it is not appropriately tailored to the structure and characteristics of the broker-dealer business model (i.e., transaction-specific recommendations and compensation), and would not properly take into account, and build upon, existing obligations that apply to broker-dealers, including under FINRA rules. Moreover, we believe (and our experience indicates), that this approach would significantly reduce retail investor access to differing types of investment services and products, reduce retail investor choice in how to pay for those products and services, and increase costs for retail investors of obtaining investment recommendations.	n/a	<u>The Proposal presents Revision Set #2 as a "menu of provisions" which NASAA views as "provid[ing] flexibility while also promoting uniformity through standardized options." Given the deviation between existing guidance and the Subparts included in Revision Set #2, partial adoption of this menu would result in additional variations of the standards of conduct that the Proposed Rule would create.</u> For reasons described below, the provisions of Revision Set #2 substantially deviate from Reg BI and existing guidance. These deviations create a new set of standards of conduct, referred to throughout as the Proposed Rule's Conflicts Standard and Proposed Rule's Care Standard. The Proposal further encourages states to select from this menu of options which, depending on whether these modifications are adopted and how the standards in these Subparts are interpreted, would lead to significant variation to broker-dealer obligations as among states. The Proposal is not aligned with the Commission's efforts to tailor an approach reflective of the structure and characteristics of the broker-dealer business model. We note that the Proposal does not indicate sharing the SEC's goals to recognize and preserve retail investor access, choice and cost structures. For purposes of this chart, we assume that the Proposed Rule would be adopted in this entirety.
7. <u>Revision Set #2 (Disclosure – Generally)</u> **Proposed Rule Text (Subpart 1.d.(1): Compliance and Disclosure):** (1) The obligations set forth in this section cannot be satisfied through disclosure alone; **Release Text:** Subpart 1d(1) is straightforward and incorporates SEC guidance from the Adopting Release (and repeated elsewhere) directly into	**Reg BI Release (p. 33318):** The standard of conduct established by Regulation Best Interest cannot be satisfied through disclosure alone. ***But compare to*** **Reg BI Release (p. 33388):** The Commission also indicated that there may be situations in which disclosure alone is not sufficient, and broker-dealers may need to establish policies and procedures designed to eliminate the conflict or both disclose and mitigate it.	n/a	<u>The Proposed Rule incorporates select disclosure language from the Reg BI Release (p. 33318) that speaks broadly to the Reg BI standard of conduct without including the nuances regarding reliance on disclosure. Therefore, the Proposal downplays the foundational role of disclosure in Reg BI.</u> The Proposal's incorporation of language from the Reg BI Release unfortunately lacks the Reg BI Release's indication that disclosure is insufficient to fully satisfy the "standard of conduct" required by Reg BI and further fails to clarify that certain conflicts of interest may be addressed through disclosure alone. While the SEC has indicated that "there *may be situations* in which disclosure alone is not sufficient," there is no presumption that insufficiency is always the case when evaluating Reg BI compliance. As further described in Row 8

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the text of the model rule. Based on examination findings the Committees believe it is necessary to emphasize and elevate this guidance into the text of the rule as many firms are relying too heavily on disclosure as their primary or sole means of complying with the care and conflict of interest obligations under Reg BI.	**Reg BI Release (p. 33319):** . . . requiring broker-dealers, among other things, to: (1) Act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer; and (2) address conflicts of interest by establishing, maintaining, and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest, and in instances where we have determined that disclosure is insufficient to reasonably address the conflict, to mitigate or, in certain instances, eliminate the conflict. Regulation Best Interest establishes a standard of conduct under the Exchange Act that cannot be satisfied through disclosure alone.		("*Revision Set #2 (Elimination of Conflicts of Interest)*"), the Proposed Rule's Care Obligation would not permit *any* conflict of interest to be addressed through disclosure alone.
8. Revision Set #2 (Elimination of Conflicts of Interest) **Proposed Rule Text (Subpart 1.d.(2): Conflicts of Interest):** (2) To ensure the broker-dealer or agent does not "place the financial or other interest of the broker-dealer or agent ahead of the interest of the retail customer," the broker-dealer or agent must make all reasonable efforts to avoid or eliminate conflicts of interest. . . . **Release Text:** NASAA's Phase II(A) Reg BI Report establishes that layered and manufactured conflicts, which are a	**§ 240.15*l*–1(a)(2)(iii):** (iii) *Conflict of interest obligation.* The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to: (A) Identify and at a minimum disclose, in accordance with paragraph (a)(2)(i) of this section, or eliminate, all conflicts of interest associated with such recommendations; (B) Identify and mitigate any conflicts of interest associated with such recommendations that create an incentive for a natural person who is an associated person of a broker or dealer to place the interest of the broker, dealer, or such natural person ahead of the interest of the retail customer;	**2022 Staff Bulletin**:[57] 11. **How should my firm satisfy its obligations to disclose conflicts of interest fully and fairly?** Additionally, the nature and extent of some conflicts may make it difficult to convey adequately to a retail investor through disclosure the material facts or the nature, magnitude, and potential effects of the conflict. Some conflicts also are difficult to disclose comprehensibly or with sufficient specificity to enable the retail investor to understand whether and how the conflict could affect the recommendation or advice they receive. In these circumstances, if the conflict cannot be fully and fairly disclosed, the	The Proposed Rule's requirement to "make all reasonable efforts to avoid or eliminate conflicts of interest" fundamentally reprioritizes broker-dealers' obligations to address conflicts of interest under Reg BI and forces a re-ordering of existing broker-dealer processes. Reg BI's conflict of interest standard relies on a combination of disclosure and—where conflicts cannot be fully and fairly disclosed or where conflicts create an incentive for the broker-dealer to place their interests above the customer—mitigation or elimination. By contrast, the Proposed Rule begins with requiring *all reasonable efforts to avoid or eliminate conflicts of interest*, only permitting disclosure *and mitigation* where conflicts of interest cannot be reasonably avoided or eliminated. The Proposed Rule would not permit *any* conflict of interest to be handled through disclosure alone.

[57] The Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest ("***2022 Staff Bulletin***"), last modified Aug. 3, 2022 (available at https://www.sec.gov/tm/iabd-staff-bulletin-conflicts-interest).

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lucrative source of extra compensation for firms and agents, are not inherent to the broker-dealer business model.	(C)(*1)* Identify and disclose any material limitations placed on the securities or investment strategies involving securities that may be recommended to a retail customer and any conflicts of interest associated with such limitations, in accordance with subparagraph (a)(2)(i), and (*2)* Prevent such limitations and associated conflicts of interest from causing the broker, dealer, or a natural person who is an associated person of the broker or dealer to make recommendations that place the interest of the broker, dealer, or such natural person ahead of the interest of the retail customer; and (D) Identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time. **Reg BI Release (p. 33319):** Like many principal-agent relationships—including the investment adviser-client relationship—the relationship between a broker-dealer and a customer has inherent conflicts of interest, including those resulting from a transaction-based (*e.g.*, commission) compensation structure and other broker-dealer compensation. **Reg BI Release (p. 33395):** We did not mandate the absolute elimination of, or policies and procedures reasonably designed to eliminate any particular conflicts. We were concerned that the absolute elimination of specified particular	firm should consider mitigation or elimination to address the conflict sufficiently. **2022 Staff Bulletin:** 6. **Are there circumstances when a particular conflict should be eliminated?** Yes. Broker-dealers and investment advisers have an obligation to act in the retail investor's best interest, including, when appropriate, eliminating conflicts. Reg BI explicitly requires broker-dealers to have written policies and procedures reasonably designed to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time. . . . Firms also may find that there are some conflicts that they are unable to address in a way that will allow the firm or its financial professionals to provide advice or recommendations that are in the retail investor's best interest. In such cases, firms may need to determine whether to eliminate the conflict or refrain from providing advice or recommendations that could be influenced by the conflict to avoid violating the obligation to act in the retail investor's best interest.	*It is noteworthy that in NASAA's Phase II (A) Reg BI Report,*[58] *NASAA confirmed that "[a]s an alternative to conflict avoidance, firms have the option under Reg BI to disclose and mitigate financial incentive conflicts." This strongly implies that NASAA understands how Reg BI handles conflicts <u>and</u> nevertheless chose to depart from the Reg BI standard in the Proposed Rule.* In addition to reprioritizing broker-dealers' obligations to address conflicts of interest, the Proposed Rule redefines "elimination." See Row 10 regarding "*Revision Set #2 (Mitigation of Conflicts of Interest)*" below for additional discussion. Further, while materiality may become relevant to the determination of "reasonable efforts" in the new Proposed Rule, there is no explicit reference to materiality in connection with conflicts of interest. Similarly, there is no explicit distinction between potential firm-level and/or financial advisor-level conflicts. However, a specific interpretation of "reasonable efforts" could help to bridge this gap. The Proposed Rule would effectively prohibit certain product types that raise conflicts of interest concerns. In contrast, the Reg BI Release confirmed the SEC's intent was not to eliminate proprietary products or certain other product types unless they were wholly out of compliance with Reg BI. Instead, Reg BI recognizes that retail customers are capable of making choices with proper disclosure and mitigation. In practice, broker-dealers revised product shelves as part of Reg BI implementation, but not because of an outright prohibition through Reg BI. In contrast, the Proposed Rule introduces an avoidance and elimination priority that presumes mitigation and disclosure are never appropriate. The Proposal, if adopted, would effectively deprive all retail customers of access to certain product types and would limit the sustainability of certain business models in jurisdictions that adopt the Proposed Rule.

[58] NASAA National Examination Initiative Phase II (A) Report and Findings of NASAA's Regulation Best Interest Implementation Committee (Nov. 2021) ("***NASAA Reg BI Phase II (A) Report***"), https://www.nasaa.org/wp-content/uploads/2021/11/NASAA-Reg-BI-Phase-II-A-Report-November-2021_FINAL.pdf.

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	conflicts could mean a broker-dealer may not receive compensation for its services. Our intent, rather, was to identify certain practices that may be more appropriately avoided for certain categories of retail customers, including, for example, sales contests, trips, prizes, and other similar bonuses based on sales of certain securities or accumulation of AUM. **Reg BI Release (p. 33394):** The Commission's intent is not to prevent firms from offering proprietary products . . . This requirement is designed to allow firms to determine whether and how to restrict their menu of investment options based, among other things, on their retail customer base and area of expertise, while protecting the interests of retail customers when recommendations are made from such limited menus by requiring firms have a reasonably designed process to identify, disclose, and prevent the conflicts of interest associated with such limitations from resulting in recommendations that place the broker-dealer's interests ahead of the retail customer's interest.		
9. <u>Revision Set #2 (Disclosure of Conflicts of Interest)</u> **Proposed Rule Text (Subpart 1.d.(2): Conflicts of Interest (Continued)):** . . . Conflicts of interest that cannot reasonably be avoided or eliminated must be disclosed and mitigated;	**§ 240.15*l*–1(a)(2)(i):** (i) *Disclosure obligation.* The broker, dealer, or natural person who is an associated person of a broker or dealer, prior to or at the time of the recommendation, provides the retail customer, *in writing, full and fair disclosure* of: . . . (B) *All material facts* relating to conflicts of interest that are associated with the recommendation. (emphasis added). **Reg BI Release (p. 33347):**	n/a	<u>The Proposed Rule does not incorporate Reg BI's disclosure standards for a conflict of interest yet requires expansive disclosure of all conflicts of interest.</u> Reg BI's disclosure obligation for a conflict of interest has detailed guidance. Disclosure of a conflict of interest must: 1. include all material facts, a. "a fact is material if there is 'a substantial likelihood that a reasonable shareholder would consider it important.' In the context of Regulation Best Interest, the standard is the retail customer, as defined in the rule." 2. be in writing, and 3. be full and fair.

Row # | Proposed Rule and Relevant Excerpts of the Proposal	Reg BI and Reg BI Release	Recent Reg BI Guidance, including Reg BI FAQ and Staff Bulletins	Commentary
	As to what constitutes a "material" fact related to the "scope and terms of the relationship," the standard for materiality for purposes of the Disclosure Obligation is consistent with the one the Supreme Court articulated in Basic v. Levinson. Specifically, a fact is material if there is "a substantial likelihood that a reasonable shareholder would consider it important." In the context of Regulation Best Interest, the standard is the retail customer, as defined in the rule. **Reg BI Release (p. 33326):** Furthermore, we are modifying the Disclosure Obligation to explicitly require broker-dealers to provide "full and fair" disclosure of material facts, rather than requiring broker-dealers to "reasonably disclose" such information. We are providing the Commission's view regarding what it means to provide "full and fair" disclosure to retail customers, including the level of specificity of disclosure required, and the form and manner and timing and frequency of such disclosure.		a. "full and fair" disclosure is a means to address the "level of specificity of disclosure required, and the form and manner and timing and frequency of such disclosure." See Row 10 regarding "*Revision Set #2 (Mitigation of Conflicts of Interest)*" below for a discussion on mitigation.
10. <u>Revision Set #2 (Mitigation of Conflicts of Interest)</u> **Proposed Rule Text (Subpart 1.d.(2): Conflicts of Interest (Continued)):** . . . Conflicts of interest that cannot reasonably be avoided or eliminated must be disclosed and mitigated; a. For purposes of this paragraph, mitigating a conflict of interest means neutralizing or reducing the potential for harm or adverse impact of the conflict to the retail customer.	**§ 240.15*l*–1(a)(2)(iii):** (iii) *Conflict of interest obligation.* The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to: . . . (B) Identify and mitigate any conflicts of interest associated with such recommendations that create an incentive for a natural person who is an associated person of a broker or dealer to place the interest of the broker, dealer, or such natural person ahead of the interest of the retail customer; . . . **Reg BI Release (p. 33391):** By requiring that a broker-dealer establish policies and procedures	**2022 Staff Bulletin:** 7. **What factors are relevant to a firm's approach to mitigating conflicts of interest?** The staff believes that the appropriate conflicts of interest mitigation measures will depend on the nature and significance of the incentives provided to the firm or its financial professionals and a firm's business model. In the staff's view, some factors related to the nature and significance of the incentives and the firm's business model may include, but are not limited to: . . .	<u>The Proposed Rule's Conflicts Obligation redefines mitigation and does not require that the standard of mitigation be based on the nature or significance of the conflict of interest.</u> *1. Under the Proposal, neutralizing harm would be treated as mitigating, rather than eliminating, a conflict of interest.* The Reg BI Release clarifies that mitigation means to "reduce the potential effect such conflicts may have on a recommendation given to a retail customer" and that elimination of a conflict of interest would "neutralize" the effect. In contrast, the Proposed Rule defines mitigation to include "neutralizing . . . the potential harm," which directly conflicts with the language of the Reg BI Release and has meaningful implications. Since "neutralization" is mitigation, the Proposal logically requires that the elimination standard under Subpart

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	reasonably designed to "mitigate" these conflicts of interest, we mean the policies and procedures must be reasonably designed to reduce the potential effect such conflicts may have on a recommendation given to a retail customer. **Reg BI Release (p. 33447):** Similarly, by addressing the effect of certain conflicts of interest through *elimination*, the Conflict of Interest Obligation is intended to *neutralize* the effect of incentives created by those conflicts may have on a recommendation provided to the retail customer. (emphasis added). **Reg BI Release (p. 33450):** By *eliminating* a conflict, the broker-dealer would *neutralize* the effect of this conflict on the recommendations provided by the broker-dealer or its associated persons to retail customers. (emphasis added).		1.d.(2) would require all reasonable efforts to avoid or to *more than neutralize* conflicts of interest. This does not align with Reg BI's focus on elimination and stated mitigation efforts as specifically detailed in the Reg BI Release. *2. The Proposed Rule does not require that the level of mitigation efforts reflect the nature or significance of the conflict of interest.* Under Reg BI and its guidance, appropriate mitigation efforts depend on the nature and significance of the incentive. By contrast, Subpart 1.d.(2) notably lacks any consideration of the nature or significance of a conflict of interest. The Proposed Rule's Conflicts Obligation in this subpart instead focuses on the "reasonable efforts" of the broker-dealer rather than the potential for harm to the retail customer.
11. <u>Revision Set #2 (Presumption of Impermissible Conflict of Interest)</u> **Proposed Rule Text (Subpart 1.d.(2): Conflicts of Interest (Continued)):** b. The broker-dealer or agent will be presumed to have placed its financial interest ahead of the interest of the retail customer where the broker-dealer or agent participates in (i) sales contests; (ii) sales quotas; (iii) bonuses; or (iv) any other non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time, or rewards the broker-dealer or agent with additional cash	**§ 240.15*l*–1(a)(2)(iii):** (iii) *Conflict of interest obligation.* The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to: . . . (D) Identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time. **Reg BI Release (p. 33396):** By explicitly requiring broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to eliminate certain practices, we believe we are responding to commenters who	**2022 Staff Bulletin:** 6. **Are there circumstances when a particular conflict should be eliminated?** Yes. Broker-dealers and investment advisers have an obligation to act in the retail investor's best interest, including, when appropriate, eliminating conflicts. Reg BI explicitly requires broker-dealers to have written policies and procedures reasonably designed to identify and eliminate any sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time. . . . Firms also may find that there are some conflicts that they are unable to address	<u>The Proposed Rule's Conflicts Obligation separately presumes a breach for various cash and non-cash awards. This presumption differs from Reg BI by expanding Reg BI's product-neutral treatment of certain sales contests and other activities.</u> The commentary in the Proposal clarifies that this presumption is *rebuttable*, but that higher scrutiny would apply where the conflicts steer agents toward more costly, more remunerative and riskier investments. However, the Proposed Rule's text lacks any clarity on how to rebut such presumption or how, or when, the related scrutiny is enhanced. Further, the Reg BI Release clarified that Reg BI "does not apply to compensation practices based on, for example, total products sold, or asset growth or accumulation, and customer satisfaction." Instead, the list in Reg BI was in response to requests for clarification regarding what practices are explicitly not permitted. The Proposed Rule categorically adds additional reward structures that the Reg BI Release permits. This approach deprives broker-dealers of the clarity that was sought in

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or non-cash compensation beyond the sales commission as the result of that recommendation. **Release Text:** Under the proposed revision, firms are not prohibited from receiving other extra forms of compensation, but firms will need to rebut the presumption that they are placing their financial interests ahead of their customers when they affirmatively choose to engage in these conflicts. Scrutiny would be heightened where the conflicts tend to steer agents toward more costly, more remunerative, and riskier investments. To the extent firms can rebut that presumption, the subpart emphasizes that those conflicts must be disclosed and mitigated consistent with SEC guidance.	requested certainty as to which specific incentives are prohibited. Also in response to commenters requesting clarification as to what practices would be permitted, the requirement to have reasonably designed written policies and procedures to eliminate sales contests, sales quotas, bonuses, and non-cash compensation applies only to those that are based on the sales of specific securities or types of securities, and *does not apply to compensation practices based on, for example, total products sold, or asset growth or accumulation, and customer satisfaction*. . . . While conflicts of interest are also associated with sales contests, sales quotas, bonuses and non-cash compensation that apply to, among other things, total products sold, or asset accumulation and growth, we agree with commenters these conflicts present less risk that the incentive would compromise compliance with the Care Obligation and Conflict of Interest Obligation such that a recommendation *could be made that is in a retail customer's best interest* and that does not place the place the interest of the broker-dealer or associated person ahead of the interest of the retail customer. (emphasis added). **Reg BI Release (p. 33376):** when a broker-dealer recommends a potentially high risk product to a retail customer—such as penny stocks or other thinly-traded securities—the broker-dealer should generally apply heightened scrutiny to whether such	in a way that will allow the firm or its financial professionals to provide advice or recommendations that are in the retail investor's best interest. In such cases, firms may need to determine whether to eliminate the conflict or refrain from providing advice or recommendations that could be influenced by the conflict to avoid violating the obligation to act in the retail investor's best interest. This can arise, as one example, when a firm adopts a compensation or incentive program that provides significant benefits or penalties based on its financial professionals' success or failure in meeting certain benchmark, quota, or other performance metrics established by the firm (beyond those that are specifically prohibited under Reg BI). In the staff's view, the greater the reward to the financial professional for meeting particular thresholds (or conversely, the more severe the consequence for failing to meet them), the greater is the concern whether the incentive program complies with Reg BI and the IA fiduciary standard. In cases where the firm finds that a particular incentive practice is causing its financial professionals to place the firm's or the financial professional's interest ahead of the retail investor's interest, the firm may need to revise its incentive program to reduce or eliminate the conflict. **2023 Staff Bulletin**:[59] 17. **Can it be consistent with a financial professional's care obligations to recommend, or**	connection with Reg BI and deviates from existing regulatory practices. As discussed in more detail in the Comment Letter, this language conflicts with Reg BI's overall compensation framework. Finally, overcoming this presumption would be in addition to—and not in lieu of—the general elimination, avoidance, mitigation and disclosure framework under the Proposed Rule.

[59] The Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Care Obligations ("***2023 Staff Bulletin***"), last modified Apr. 20, 2023 (available at https://www.sec.gov/tm/standards-conduct-broker-dealers-and-investment-advisers).

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	investments are in a retail customer's best interest.	**provide advice about, a complex or risky product?** . . . In the view of the staff, firms and financial professionals should consider whether less complex, less risky or lower cost alternatives can achieve the same objectives for their retail customers as part of their overall reasonable basis analysis. Moreover, firms and their financial professionals generally should apply "heightened scrutiny" to whether a risky or complex product is in the retail investor's best interest.	
12. <u>Revision Set #2 (Standard for Proposed Rule's Care Obligation)</u> **Proposed Rule Text (Subpart 1.d.(3): Care, Skill and Diligence):** (3) To ensure the recommendation is "in the best interest of the retail customer" for purposes of this subsection, the broker-dealer or agent must use the care, skill, and diligence that a person acting in a like capacity and familiar with such matters would use, taking into consideration all of the relevant facts and circumstances.	**§ 240.15*l*–1(a)(2)(ii):** (ii) *Care obligation.* The broker, dealer, or natural person who is an associated person of a broker or dealer, in making the recommendation, exercises reasonable diligence, care, and skill to: (A) Understand the potential risks, rewards, and costs associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers; (B) Have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation and does not place the financial or other interest of the broker, dealer, or such natural person ahead of the interest of the retail customer; . . . **Reg BI Release (p. 33372):** As discussed in more detail below, in response to comments, we are revising the Care Obligation to remove the term "prudence," as we have concluded that its inclusion creates legal uncertainty and confusion, and it is redundant of	n/a	<u>The Proposed Rule's Care Obligation would add a new, undefined "*a person acting in a like capacity and familiar with such matters would use*" standard.</u> The Proposed Rule partially follows the Reg BI requirement that the broker-dealer "exercises reasonable diligence, care, and skill," but it deviates from Reg BI's "*reasonable*" standard, instead applying "the care, skill, and diligence that *a person acting in a like capacity and familiar with such matters would use*, taking into consideration all of the relevant facts and circumstances." The standard of a person acting in a like capacity is similar to the prudence standard usually associated with ERISA fiduciary duty. When adopting Reg BI, the SEC specifically considered, and rejected, a prudence standard, opting instead to require "reasonable diligence, care, and skill" to have a "reasonable basis to believe that the recommendation is in the best interest" of the retail customer. In the Reg BI Release, the Commission concluded that the inclusion of a prudence standard "creates legal uncertainty and confusion, and it is redundant of what [the Commission] intended in requiring a broker-dealer to exercise 'diligence, care, and skill.'" (p. 33372). Even without the direct reference to prudence, the new "a person acting in a like capacity" standard introduces uncertainty. It is unclear whether factors such as geographic location, business model or other licensures could be implied with the term "acting in like capacity."

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	what we intended in requiring a broker-dealer to exercise "diligence, care, and skill," and its removal does not change the requirements under the Care Obligation.		
13. <u>Revision Set #2 (Proposed Rule's Care Obligation – Relevant Facts and Circumstances)</u> **Proposed Rule Text (Subpart 1.d.(3)a.: Care, Skill and Diligence (Continued)):** a. The relevant facts and circumstances include: 1. The risks, costs, and conflicts of interest related to the recommendation made and any related investment advice given to the retail customer; 2. Securities and investment strategies that can achieve the retail customer's investment objectives with less risk or less costs; 3. The customer's age, education, other investments, debt, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance; and 4. Any other relevant information.	**§ 240.15*l*–1(b)(2):** (2) *Retail customer investment profile* includes, but is not limited to, the retail 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 retail customer may disclose to the broker, dealer, or a natural person who is an associated person of a broker or dealer in connection with a recommendation. **§ 240.15*l*–1(a)(2)(ii):** (ii) *Care obligation.* The broker, dealer, or natural person who is an associated person of a broker or dealer, in making the recommendation, exercises reasonable diligence, care, and skill to: (A) Understand the potential risks, rewards, and costs associated with the recommendation, and have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers; **Reg BI Release (p. 33334):** In particular, whether a broker-dealer's recommendation satisfies the requirements of the Care Obligation is an objective evaluation that is not	**2023 Staff Bulletin:** 5. **What is an "investment profile?" How does the investment profile help me satisfy my care obligation?** The term "investment profile" *refers to information that the firm or financial professional generally should make reasonable efforts to ascertain about the retail investor . . . .* The reasonableness of efforts to collect information needed about a retail investor's financial situation, investment objectives, and other information and characteristics of that retail investor to meet this requirement *depends on the specific facts and circumstances of the particular situation, including considering the nature and characteristics of the investment or investment strategy at issue. . . .* *As part of establishing a reasonable understanding of the retail investor's investment profile, the staff believes that you generally should seek to obtain and consider, without limitation: the investor's financial situation (including current income) and needs; investments; assets and debts; marital status; tax status; age; investment time horizon; liquidity needs; risk tolerance; investment experience; investment*	<u>The Proposed Rule includes a more prescriptive and extensive listing of relevant facts and circumstances that must be "tak[en] into consideration" under Subpart 1.d.(3). Some of these requirements roughly correlate to Reg BI's investor profile requirement.</u> The Proposed Rule's text roughly follows the "retail investor profile" in Reg BI, but the Proposed Rule further includes "*costs, . . . Securities and investment strategies that can achieve the retail customer's investment objectives with less risk or less costs, . . . education, . . . debt, . . . and . . . any other relevant information*."[60] The 2023 Staff Bulletin addresses many questions tailored to investor profile and relevant considerations. The staff explicitly acknowledged the Commission's "factors [are] non-exhaustive and you can, and in some cases may need to, consider additional or different factors as appropriate under the specific facts and circumstances of the retail investor or the recommendation or advice." Further, some of the guidance focuses on incomplete investor profiles, acknowledging that broker-dealers may at times provide adequate recommendations with incomplete information. Even the catchall language in the Proposed Rule is more prescriptive. Reg BI includes "any other information the retail customer may disclose" whereas the Proposed Rule considers "any other relevant information."[61] Additionally, the Proposed Rule would require more frequent updates of investor information than Reg BI. The 2023 Staff Bulletin notes "[b]roker-dealers generally should make a reasonable effort to ascertain information regarding an existing

[60] While not related to Reg BI, we note that the Proposed Rule's identified facts and circumstances are inconsistent with the proposed changes to the definition of "retail customer." Facts and circumstances regarding "age" and "education" apply to individuals. Under the proposed expansion to "retail customer," legal persons could be retail customers for which these terms do not apply. The Proposal's bright line approach to these considerations is misaligned with the Proposal's framework.

[61] We note that the Proposed Rule does not include the concept of quantitative suitability (§ 240.15*l*–1(a)(2)(ii)(C)) as part of the Proposed Rule's Care Obligation. NASAA may have intended the "other relevant information" prong to capture this concept.

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	susceptible to a bright line test; rather it turns on the facts and circumstances of the particular recommendation and the particular retail customer, at the time the recommendation is made. This facts-and-circumstances approach recognizes that one size does not fit all, and what is in the best interest of one retail customer may not be in the best interest of another.	*objective and financial goals; and any other information the retail investor may disclose to you in connection with the recommendation or advice*. This list of factors is non-exhaustive and you can, and *in some cases may need to, consider additional or different factors* as appropriate under the specific facts and circumstances of the retail investor or the recommendation or advice. . . . 6. **Is gathering information for the retail investor's investment profile a once-and-done exercise?** . . . Broker-dealers generally should *make a reasonable effort* to ascertain information regarding an existing retail investor's investment profile prior to the making of a recommendation on an "as needed" basis—that is, where a broker-dealer *knows or has reason to believe that the customer's investment profile has changed, and must periodically attempt to update customer account information consistent with existing Exchange Act books and records requirements*. . . . 7. **What do I do if investor information is unavailable?** . . . The staff believes you will not be able to have a reasonable belief that a recommendation or advice is in a retail investor's best interest *without sufficient information* about the retail investor, and therefore should generally decline to provide such recommendations or advice until you obtain the necessary investor information. If you determine *not to obtain or evaluate information that would normally be contained in an investment profile, the staff believes you should consider documenting the basis for your belief that such information is not relevant in light of the facts and*	retail investor's investment profile prior to the making of a recommendation on an 'as needed' basis—that is, where a broker-dealer knows or has reason to believe that the customer's investment profile has changed, and must periodically attempt to update customer account information consistent with existing Exchange Act books and records requirements." The Proposed Rule would specifically apply each time a recommendation is made, which could imply that the new retail customer investor profile requirements are fully revisited in connection with each recommendation. For additional discussion regarding the Proposed Rule's inclusion of "Securities and investment strategies that can achieve the retail customer's investment objectives with less risk or less costs" see Row 14 regarding "*Revision Set #2 (Proposed Rule's Care Obligation – Reasonable Inquiries)*."

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		circumstances of the particular recommendation or advice. (emphasis added).	
14. <u>Revision Set #2 (Proposed Rule's Care Obligation – Reasonable Inquiries)</u> **Proposed Rule Text (Subpart 1.d.(3)b.: Care, Skill and Diligence (Continued)):** b. To satisfy this care obligation, a broker-dealer or agent shall make reasonable inquiry regarding lower-cost and lower-risk securities and investment strategies that are reasonably available to the broker-dealer or agent, as well as products or services available if the agent is also [licensed/registered] in other capacities such as an investment adviser representative or insurance agent.	**Reg BI Release (p. 33381):** In particular, we are not requiring a natural person who is an associated person of the broker-dealer to be familiar with every product on a broker-dealer's platform, particularly where a broker-dealer operates in an open architecture framework or otherwise operates a platform with a large number of products or options. Such a requirement might not allow an associated person of a broker-dealer to develop a proper understanding of every security or investment strategy's potential risks, rewards, or costs, and thus it might not be possible to fulfill the obligation set forth in paragraph (a)(2)(ii)(A). Furthermore, such a requirement could encourage broker-dealers to limit their product menus or otherwise restrict access to products and services currently available to retail customers, which is contrary to the purpose and goals of Regulation Best Interest. **Reg BI Release (p. 33381):** Accordingly, in fulfilling the Care Obligation, the associated person should exercise reasonable diligence, care, and skill to consider reasonably available alternatives offered by the broker-dealer. This exercise would require the associated person to conduct a review of such reasonably available alternatives that is reasonable under the circumstances. Consistent with the Compliance Obligation discussed below, a broker-dealer should have a reasonable process for establishing and understanding the scope of such "reasonably available alternatives" that would be considered by particular	**2023 Staff Bulletin:** 9. **Should I consider reasonably available alternatives when recommending or providing advice about investments or investment strategies to retail investors?** Yes. It would be difficult for firms and their financial professionals to form a reasonable basis to believe a recommendation or advice is in the retail investor's best interest without considering alternatives that are reasonably available to achieve the investor's investment objectives. . . . The firm or financial professional, in the view of staff, should conduct a comparative assessment of these alternatives in order to identify the investments or investment strategies that they reasonably believe are in the retail investor's best interest. Ultimately, the staff believes what will be a reasonable consideration of available alternatives by firms or financial professionals will depend on the facts and circumstances. . . . 14. **Does every investment or investment strategy have a reasonably available alternative?** The staff recognizes that product innovation, particularly in the realm of complex products, has resulted in the development of products with highly particular features that make them unique. However, the staff believes that products that are not identical may still be comparable to each other for purposes of identifying them as reasonably available alternatives based on the retail investor's investment profile, among other factors. . . . In the	<u>The Proposed Rule includes a separate obligation to make a "reasonable inquiry regarding (1) lower-cost and lower-risk securities and investment strategies that are reasonably available to the broker-dealer or agent," and (2) "products or services available if the agent is also [licensed/registered] in other capacities such as an investment adviser representative or insurance agent." This is similar to, but not in full alignment with, the Reg BI Care Obligation reasonable basis prong and the related developments on reasonably available alternatives.</u> The Reg BI Release and the staff bulletins discuss "reasonably available alternatives" rather than lower-cost and/or lower-risk securities and investment strategies. The Proposal's approach assumes that lower-cost and lower-risk securities and investment strategies exist and affirmatively requires an "inquiry" into those types of options. By contrast, the staff bulletins discuss a more holistic approach since "the unique features and benefits of alternatives considered do not need to be an exact match so long as the risks, rewards and costs associated with the alternatives are consistent with the retail investor's investment profile." When drafting Reg BI, the Commission elected to provide guidance that clarifies there is no requirement that an associated person of a broker-dealer be familiar with every product on the applicable platform. The Commission was concerned that this requirement would be counterproductive and would encourage broker-dealers to limit their offerings. We note that the contours of this will be shaped through SEC enforcement matters (investigation and litigation), which are currently ongoing. The Proposed Rule would create a new standard that could similarly be refined through a separate set of enforcement matters. In general, the Proposed Rule requires a broker-dealer to "make reasonable inquiry regarding . . . products or services available if the agent is also [licensed/registered] in other capacities such as an investment adviser representative or insurance agent." In practice, the Proposal would potentially encourage broker-dealers to limit product offerings to avoid allegations of not making a "reasonable inquiry" into alternative offerings. The Proposal does not address how a broker-dealer operating in an open architecture framework would comply with the new standards included in the Proposed Rule.

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	associated persons or groups of associated persons (*e.g.*, groups that specialize in particular product lines) in fulfilling the reasonable diligence, care, and skill requirements under the Care Obligation. **Reg BI Release (p. 33382):** We recognize that the process by which a broker-dealer and its associated persons develop and make recommendations to retail customers, including the scope of reasonably available alternatives considered, will depend upon a variety factors, including the nature of the broker-dealer's business. The disclosure of this process pursuant to the Disclosure Obligation will provide critical information to retail customers and underscores our acknowledgment that we do not expect every broker-dealer or associated person to follow the same process. Instead, consistent with the Compliance Obligation, broker-dealers and their associated persons must have a reasonable process for developing and making recommendations to retail customers in compliance with the Care Obligation, including the consideration of reasonably available alternatives, which will depend on the facts and circumstances.	staff's view, the unique features and benefits of alternatives considered do not need to be an exact match so long as the risks, rewards and costs associated with the alternatives are consistent with the retail investor's investment profile.	
15. <u>Revision Set #2 (Proposed Rule's Care Obligation – Costs)</u> **Proposed Rule Text (Subpart 1.d.(4): Costs):** (4) For purposes of this subsection, "costs" include the sum total of all potential fees and costs based on the anticipated holding period for the security or investment strategy that is recommended by the broker-dealer or agent.		**2023 Staff Bulletin**: **3. Are costs always a relevant factor to consider when recommending or providing advice on investments or investment strategies?** Yes. While costs should not be the only consideration, and a firm or financial professional cannot satisfy its obligations simply by recommending the lowest cost option, the firm and financial professional must always consider cost as a factor when	<u>Under the Proposed Rule, considerations of specific "costs" are relevant to the Proposed Rule's Care Obligation, which expands on Reg BI's approach to costs.</u> Reg BI requires disclosure of "material" costs and further requires exercising reasonable diligence, care and skill to understand costs and consider the costs when evaluating if the recommendation is in the best interest of the retail customer. However, "costs" is not defined in Reg BI, allowing a facts and circumstances analysis, as illustrated in the 2023 Staff Bulletin. In contrast, the Proposed Rule would include a specific calculation of the sum total of all potential fees and costs,

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a. "Costs" include but are not limited to account fees, commissions, other transactional costs such as markups and markdowns, costs arising from tax considerations, costs associated with payment for order flow and cash sweep programs, and other indirect costs that could be borne by the retail customer. b. When applicable, "costs" also include fees associated with the investment products that are available through the account, such as the internal expenses of funds, management fees, distribution and servicing fees, including any front-end and back-end fees. c. To the extent that certain "costs," such as distribution and servicing fees and transactional costs, depend on the retail customer's anticipated investment horizon, the broker-dealer or agent is to consider the potential impact of those costs on the customer's account based on an understanding of that horizon.		providing a recommendation or advice to a retail investor. In the staff's view, the firm and financial professional should consider the *total potential costs when evaluating whether the recommendation or advice is in a retail investor's best interest, including direct and indirect costs that could be borne by the retail investor*. For example, when determining whether an investment or investment strategy is in the investor's best interest, in the staff's view, the firm and financial professional should consider, where relevant, the following *non-exhaustive list of potential costs: commissions, markups or markdowns, and other transaction costs; sales loads or charges; advisory or management fees; other fees or expenses that may affect a retail investor's return (such as Rule 12b-1 fees, other administrative and service fees, revenue sharing, and transfer agent fees); the trading and other costs associated with an investment strategy (such as the need to continually buy and sell options or futures contracts or pay margin interest, daily rebalance fees, and any structural features of the investment that could magnify investor losses); the costs of exiting an investment or investment strategy (such as deferred sales charges or liquidation costs); any relevant tax considerations;* and the likely impacts of those costs over the retail investor's expected time horizon. In other words, an analysis of costs, in the staff's view, should include costs beyond the explicit costs disclosed on a trade confirmation or account statement." (emphasis added).	including amounts based on anticipated holding periods and tax considerations. This would be a prescriptive calculation that could need to be recalculated to include the broker-dealer's projection of potential fees and costs for each specific retail customers' anticipated holding period, tax considerations, etc. See the Comment Letter for more discussion regarding costs.

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16. <u>Revision Set #2 (Recommendations and Unsolicited Transactions)</u> **Proposed Rule Text (Subpart 1.d.(5): Recommendations):** (5) The obligations set forth in this section do not apply to unsolicited transactions that a broker-dealer or agent execute for a customer in a self-directed or nondiscretionary account. If the broker-dealer or agent utilized any means, method or mechanism to feature or promote an account type, specific security or investment strategy to a retail customer, whether directly or through a third-party, then that transaction will not be deemed an unsolicited transaction, but rather will be deemed a recommendation to which all of the foregoing obligations set forth in this subsection apply. **Release Text:** Subpart 1d(5) is a provision that attempts to clarify what qualifies as a "recommendation" subject to the model rule. A "recommendation" is a well-established concept with sufficient elasticity to accommodate technological advancements within the industry.	**Reg BI Release (p. 33339):** While certain commenters recommended formally defining the term "recommendation," including what does not come within that term, other commenters maintained there is no need to define ''recommendation'' and expressed support for harmonizing the term in accordance with existing broker-dealer guidance and case law. We agree with commenters that clarity is important, and we continue to believe that the current principles-based approach underlying existing Commission precedent and guidance will provide effective clarity. Being more prescriptive could result in a definition that is over inclusive, under inclusive, or both. *We believe that what constitutes a recommendation is highly fact-specific and not conducive to an express definition in the rule text.* Furthermore, we believe that the existing framework has worked well, that broker-dealers generally are familiar with the existing framework, and therefore, that this approach should continue. Accordingly, we are taking the approach as set forth in the Proposing Release, which we believe provides a workable framework and clarity for broker-dealers regarding the contours of a recommendation. **Reg BI Release (pp. 33334-5):** Finally, some commenters sought additional clarity whether Regulation Best Interest would extend beyond a particular recommendation, impose a duty to monitor the retail customer's account, or apply to unsolicited orders. We confirm that, consistent with the Proposing Release and as discussed	**Frequently Asked Questions on Regulation Best Interest**[62] Q: I am an associated person of a broker-dealer. If I meet and talk with a prospective retail customer in an informal setting (e.g., on the golf course, at social gatherings, or while running errands), is my communication (sometimes referred to as a "hire me" communication) subject to Regulation Best Interest? A: Whether your communication is subject to Regulation Best Interest depends on whether you make a "recommendation," not on the location or setting of the communication. Regulation Best Interest applies to a "recommendation of a securities transaction or investment strategy involving securities (including account recommendations) to a retail customer." The Commission interprets whether a "recommendation" has been made to a retail customer that triggers the Regulation Best Interest obligations consistent with the precedent under the anti-fraud provisions of the federal securities laws as applied to broker-dealers, and with how the term has been applied under the rules of self-regulatory organizations. Under this existing framework, a factor to consider is whether the communication "reasonably could be viewed as a 'call to action.'" The more individually tailored the communication to a specific customer or a targeted group of customers, the greater the likelihood that the communication may be viewed as a "recommendation."	<u>The Proposed Rule broadly expands the definition of "recommendation" to include "any means, method or mechanism to feature or promote an account type, specific security or investment strategy to a retail customer, whether directly or through a third-party." In contrast, the Reg BI approach to a recommendation is narrower and defers to existing guidance and case law.</u> 1. *Technological advances and "any means, method or mechanism"* The commentary in the Proposal reasonably notes that a "recommendation" is "a well-established concept with sufficient elasticity to accommodate technological advancements within the industry" yet then expands the definition of recommendation. Specifically, the Proposed Rule's inclusion of "any means, method or mechanism to feature or promote an account type, specific security or investment strategy to a retail customer" as a "recommendation" exceeds the well-established definition. This expansion is not limited to technological advancements and potentially captures advertisements and articles. 2. *Redefining "recommendation" as part of the review of standards of conduct, in advance of ongoing SEC consideration* While the Commission did not use the adoption of Reg BI as an avenue to redefine "recommendation," the Commission is actively engaged in efforts around predictive data analytics and other matters that could revise the scope of Reg BI. NASAA's attempt to redefine "recommendation" in connection with new conduct standards could conflict with the Commission's efforts to review this separately from conduct standards for broker-dealers. 3. *Potential additional areas of expansion* The Reg BI Release clarified that Reg BI "*would not:*(1) Extend beyond a particular recommendation or generally require a broker-dealer to have a continuous duty to a retail customer or impose a duty to monitor; (2) require the broker-dealer to refuse to accept a customer's order that is contrary to the broker-dealer's recommendation; or (3) apply to self-directed or

[62] Frequently Asked Questions on Regulation Best Interest, last modified Aug, 4, 2020 (available at https://www.sec.gov/tm/faq-regulation-best-interest).

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	further below, Regulation Best Interest would not: (1) Extend beyond a particular recommendation or generally require a broker-dealer to have a continuous duty to a retail customer or impose a duty to monitor; (2) require the broker-dealer to refuse to accept a customer's order that is contrary to the broker-dealer's recommendation; or (3) apply to self-directed or otherwise unsolicited transactions by a retail customer, whether or not she also receives separate recommendations from the broker-dealer.	If you engage in a communication with a retail customer that rises to the level of a "recommendation," whether in the context of a "hire me" conversation or otherwise, the recommendation will be subject to Regulation Best Interest. Not all communications with a prospective retail customer will rise to the level of a recommendation. For example, consider a scenario where you meet a prospective retail customer at a dinner party and say: "I have been working with our mutual friend, Bob, for fifteen years, helping him to invest for his kids' college tuition and for retirement. I would love to talk with you about the types of services my firm offers, and how I could help you meet your goals. Here is my business card. Please give me a call on Monday so that we can discuss." Absent other factors, in the staff's view this communication would not be a "recommendation" subject to Regulation Best Interest, as the staff does not believe this communication in and of itself would reasonably be viewed as a "call to action" to open an account, engage in a securities transaction or act on an investment strategy. (Posted January 10, 2020)	otherwise unsolicited transactions by a retail customer, whether or not she also receives separate recommendations from the broker-dealer." (emphasis in original). Additional clarity is needed regarding whether the added "elasticity" to recommendations under the Proposed Rule would conform with these restrictions. *4. Actions of third parties* Moreover, recommendations under the Proposed Rule can occur "through a third-party." The existing NASAA model rule applies only to broker-dealers and agents. The Proposed Rule would create a new category of third parties who could make recommendations on the broker-dealers' behalf without being considered an agent under applicable law. Taken together with the Proposed Rule's expansion of "retail customer" (see Row 17: "*Revision Set #2 (Retail Customer)*"), the Proposed Rule could expand Reg BI's definition of "recommendations" to include advertisements, actions by non-agents and other actions that do not create a contractual or financial benefit for the broker. See the Comment Letter for further discussion.
17. <u>Revision Set #2 (Retail Customer)</u> **Proposed Rule Text (Subpart 1.d.(6): Retail Customer):** (6) For the purposes of this section, the term "retail customer" shall include current and prospective customers and clients, but shall not include: a. A bank, savings and loan association, insurance company,	**§ 240.15*l*–1(b)(1):** (1) *Retail customer* means a natural person, or the legal representative of such natural person, who: (i) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and	FINRA Regulatory Notice 12–55 at Q6(b), which is referenced in FN 260 of the Reg BI Release: **Question 6 from *Regulatory Notice 12-25* is now 6(a) with a new answer** **Q6(a). What constitutes a "customer" for purposes of the suitability rule?** A6(a). The suitability rule applies to a broker-dealer's or registered	<u>The Proposed Rule would redefine "retail customer" to include all current and prospective customers and clients subject to limited, enumerated carve-outs. The Proposal also abandons Reg BI's requirement that retail customers "use[] the recommendation primarily for personal, family, or household purposes."</u> *1. <u>Natural Persons (or Their Representatives):</u>* Reg BI is intended to "*exclude recommendations related to commercial or business purposes*" and limits the definition of "retail customers" to "a natural person, or the legal

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trust company, or registered investment company; b. A broker-dealer registered with a state securities regulator; c. An investment adviser registered with the SEC under Section 203 of the Investment Advisers Act of 1940 or with a state securities regulator; or d. Any other institutional buyer, as defined in [state rule citation].	(ii) Uses the recommendation primarily for personal, family, or household purposes. **Reg BI Release (pp. 33341-2):** The definition was generally intended to track the definition of ''retail customer'' under Section 913(a) of the Dodd-Frank Act with some differences, as described in the Proposing Release. In proposing the definition, we intended to exclude recommendations related to commercial or business purposes but for the definition to remain sufficiently broad to capture recommendations related to the various reasons retail customers may invest, such as saving for retirement, education expenses and other savings purposes. **Reg BI Release (p. 33344):** . . .we interpret that a retail customer "uses" a recommendation of a securities transaction or investment strategy involving securities when, as a result of the recommendation: (1) The retail customer opens a brokerage account with the broker-dealer, regardless of whether the broker-dealer receives compensation, (2) the retail customer has an existing account with the broker-dealer and receives a recommendation from the broker-dealer, regardless of whether the broker-dealer receives or will receive compensation, directly or indirectly, as a result of that recommendation, or (3) the broker-dealer receives or will receive compensation, directly or indirectly as a result of that recommendation, even if that retail customer does not have an account at the firm. **Reg BI Release (p. 33345):**	representative's recommendation of a security or investment strategy involving a security to a "customer." FINRA's definition of a customer in FINRA Rule 0160 excludes a "broker or dealer." In general, for purposes of the suitability rule, the term customer includes a person who is not a broker or dealer who opens a brokerage account at a broker-dealer or purchases a security for which the broker-dealer receives or will receive, directly or indirectly, compensation even though the security is held at an issuer, the issuer's affiliate or a custodial agent (*e.g.*, "direct application" business, "investment program" securities, or private placements), or using another similar arrangement.	representative of such natural person." The Proposed Rule reject's Reg BI's approach and includes *all persons and entities*, unless one of the limited exceptions is met. The Proposed Rule's definitional deviation would cause the Proposed Rule to apply to certain broker-dealers who are entirely outside of the scope of Reg BI based on their existing customer base. *2. <u>Uses:</u>* In addition to the natural person requirement, Reg BI considers the *uses* of the recommendation when evaluating if a customer is a retail customer. Note that the Reg BI Release leverages the "use" analysis to enforce the "personal, family, or household" purposes requirement and to further require that there is some activity that constitutes "use" of the recommendation. As described in the Reg BI Release, "use" includes the following: (1) opening a brokerage account with the broker-dealer, regardless of whether the broker-dealer receives compensation, (2) has an existing account with the broker-dealer and receives a recommendation from the broker-dealer, regardless of whether the broker-dealer receives or will receive compensation, directly or indirectly, as a result of that recommendation, or (3) the broker-dealer receives or will receive compensation, directly or indirectly as a result of that recommendation. Without the "use" requirement, the Proposal deviates from Reg BI. Furthermore, the Proposal would have no built-in protections on state regulators for what constitutes a customer relationship. Pursuant to Reg BI, there is not obligation that a prospective customer have or create an account with the broker-dealer or otherwise take an action that would result in payment to the broker-dealer. In contrast, the Proposed Rule would apply to the making of the recommendation, regardless of whether the recommendation results in any action or traceable relationship with the broker-dealer. *3. <u>Prospective customers and clients:</u>* Reg BI addresses "prospective" customers when determining whether the recommendation is *used* by a retail customer. By contrast, the Proposed Rule specifically includes "prospective customers and clients."

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	For the reasons discussed in the Proposing Release and in response to commenters who requested clarification on whether Regulation Best Interest applies to prospective customers, we would like to clarify that the definition of "retail customer" does not apply to prospective customers who do not receive and use recommendations from a broker-dealer, as discussed above. This distinction reflects differences between the point in time the Relationship Summary is delivered to an investor and when the obligations of broker-dealers pursuant to Regulation Best Interest attach. **Reg BI Release (p. 33345):** Whether the recommendation complies with Regulation Best Interest will be evaluated based on the circumstances that existed *at the time the recommendation was made* to the retail customer. Accordingly, broker- dealers should carefully consider the extent to which associated persons can make recommendations to prospective retail customers (*i.e.,* that have received, but not yet "used" the recommendation as noted above) in compliance with Regulation Best Interest, including having gathered sufficient information that would enable them to comply with Regulation Best Interest at the time the recommendation is made, should the prospective retail customer use the recommendation. (emphasis added).		The expansion of recommendation, particularly with respect to the Proposed Rule's Conflicts of Interest standard and the narrow carve-out for unsolicited transactions create an extremely broad rule. This could have a chilling effect on customer outreach, education and advertising. See Row 2 regarding "*Revision Set #1 (Definition of Recommendation)*" and Row 16 regarding "*Revision Set #2 (Recommendations and Unsolicited Transactions)*" for additional detail and commentary. *4. <u>Clients:</u>* As a final point, the Proposed Rule specifically includes "clients" in addition to customers. Historically, "clients" was used to refer to the clientele of investment advisers. It is unclear how the Proposed Rule is altered by this addition. Note that the Proposed Rule (which is solely for broker-dealers) refers to broker-dealers' clientele as "customers," which has remained unchanged.
18. <u>Revision Set #2 (Savings Clause</u> **Proposed Rule Text (Subpart 1.d.(7) and 1.d.(8) Savings Clause):** (7) Nothing in this section shall be construed to apply to a person acting in the capacity of a fiduciary to an employee benefit plan, its	n/a	n/a	See Appendix 1 of the Comment Letter for a detailed discussion on the savings clause and preemption.

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participants, or its beneficiaries, as those terms are defined in the Employee Retirement Income Security Act (ERISA), 29 U.S.C. §§ 1001 et seq. (8) Nothing in this section shall be construed to establish any requirements for capital, custody, margin, financial responsibility, making and keeping of records, bonding, or financial or operational reporting for any broker-dealer or agent that differ from, or are in addition to, the requirements established under 15 U.S.C. § 78o(i).			
19. <u>Revision Set #3 ("Adviser" and "Advisor")</u> **Proposed Rule Text (Part 1.e.):** e. Using a title, purported credential, or professional designation containing any variant of the terms "adviser" or "advisor" without licensure as either an investment adviser or an investment adviser representative, unless otherwise permitted by law.	**Reg BI Release (p. 33352):** presume[s] that the use of the terms "adviser" and "advisor" in a name or title by (i) a broker-dealer that is not also registered as an investment adviser or (ii) an associated person that is not also a supervised person of an investment adviser to be a violation of the capacity disclosure requirement under Regulation Best Interest. **Reg BI Release (p. 33353):** In most instances, however, when a broker-dealer uses these terms in its name or title in the context of providing investment advice to a retail customer, they will generally violate the capacity disclosure requirement under Regulation Best Interest.	n/a	<u>The Proposed Rule generally prohibits using the terms "adviser" or "advisor" without licensure as either an investment adviser or an investment adviser representative. Reg BI presumes the use of these terms is a violation.</u> In practice, Reg BI and the Proposed Rule generally align on this point, with the notable exception of applying the term financial advisor to a broker-dealer supervisor who is not also registered as an investment adviser representative. In these instances, the Proposed Rule is not aligned with Reg BI's framework.