INSTITUTE FOR
THE FIDUCIARY STANDARD

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RE: ARRC 4998 - best interest standard of care for insurance and securities professionals

Dear Ms Swalwell:

I write on behalf of the Institute for the Fiduciary Standard to comment on ARRC 4998C - best interest standard of care for insurance and securities professionals.

The Institute for the Fiduciary Standard is a non profit formed in 2011 for the singular purpose of advancing fiduciary principles and practices in investment advice and financial planning. We produce white papers and engage in education and advocacy through our programing. This includes commentary on the current SEC rulemaking. A recent paper, on the new SEC and CFP Board rules is attached. More information may be found on our website. https://thefiduciaryinstitute.org/

A best interest standard should reflect the common law duties of loyalty and care. It should stress the importance of avoiding or eliminating conflicts when possible, as opposed to disclosing conflicts. Stating that conflict disclosure alone is presumed insufficient to meet the duty of loyalty is important. Effectively managing conflicts is as important in 2020 to investors and the markets as it was to the framers of the Investment Advisers Act of 1940.

In this comment I note how deficient is Reg BI and a specific provision where the proposed rule is particularly beneficial in exceeding the requirements of Reg BI.

Reg BI falls way short of requiring the necessary provisions to serve an investor's best interest

What is Reg BI? Reg BI is widely opposed outside Wall Street and Washington. This is no surprise. Investor advocates, advisor groups, independent experts, state securities administrators and investors themselves have expressed major concerns. A review of letters for the Reg BI proposal raises a basic question: Are there any independent and credible experts who support the rule and also address critics' concerns about the rule? There is not one that we can find.

There is a divide between Reg BI adherents and fiduciary advocates and investors that is real and deep. They reside on different planets, relying on different data and analysis, speaking different languages. It makes meaningful discussion all but impossible. This lack of meaningful discussion endangers the body politic of the country.

With sadness I note that the dialogue between rulemaking adherents and fiduciary advocates and investors got even worse July 8. Then the SEC defended rulemaking and criticizes the critics. Criticism of the rulemaking is called, "false, misleading, misguided." This language is not good for the rulemaking process. Neither is it good for the country.

Alternatively, imagine if critics, along with neutral scholars, had been invited to a meeting to discuss differences? There are significant issues that could actually have been discussed. Here are three.

One, Reg BI clearly appears to impose a suitability-like standard.

First, Reg BI language on 'best interest' is from FINRA's suitability rule. Cases cited by the SEC state, "A brokers recommendation must be consistent with a customers' best interest." The point is FINRA already says broker recommendations must meet a best interest standard. If so, changes brokers must make to meet a best interest standard are?

If a BD recommendation is in a customer's best interest under FINRA current rules, when BDs define *disclosure, care* and *compliance policies*, why is the same transaction under Reg BI NOT also in the best interest?

The bottom line. The foundation of Reg BI is largely the BDs' current FINRA obligations.

Two, Reg BI does not define best interest. So BD's will.

The cornerstone of Reg BI is firm compliance. BDs are granted great flexibility to write, interpret and enforce their policies and procedures. Including if mitigation of a conflict is called for. This will be decided by BD compliance staff, whether a recommendation creates an incentive that places the interest of the broker or firm ahead of the customer. (Regulation Best Interest, 2iii (B)).

It raises the question of who is the regulated and who is the regulator. The Reg BI release explains, "We proposed a principles-based approach to provide flexibility to firms to develop and; tailor policies and procedures that include conflict mitigation measures based on each firms circumstances." (Release, page 322)

"Flexibility" means BDs get lots of discretion. Reg BI claims this beats "mandating specific mitigation measures" (331) because, "broker-dealers are most capable of identifying and addressing the conflicts that may affect the obligations of their associated persons with respect to the recommendations they make." (326) It appears that BDs are the deciders and the SEC has just sent BDs a vote of confidence that the SEC believes they will decide well – as the SEC might.

The SEC explains, "This approach appropriately balances our goal of reducing the potential harm that conflicts of interest have on broker dealers' recommendations to retail customers (through mitigation) and preserving retail access (in terms of choice and access) to brokerage products and services." (328) This candid admission appears to justify an explicit and conscious tradeoff between greater mitigation and greater investor harms. It appears to approve such greater investor harms for the sole purpose to preserve the BDs' business model.

The bottom line. Reg BI does not "define" 'best interest', so BD's will effectively define it. They will write, interpret and then enforce their own policies and procedures. They will do so believing, and understandably so, they already serve customers best interest. They will do so confidently because, as Reg BI asserts, "they are most capable" to do so. The clear message: BDs will enforce their policies and procedures just as the SEC might.

Three, rule-making ambiguity is seen in confusing or misleading messages. The SEC June 5, 2019 Fact Statement states Reg BI "Cannot be satisfied through disclosure alone." Misleading messages about conflict disclosure and mitigation abound. Ambiguity muddles language and causes confusion –even among professionals.

John Taft is vice chairman of Baird and former chair of the Securities Industry and Financial Markets Association (Sifma). He is one of the most experienced BD lobbyists in Washington. He recently wrote that conflict mitigation is required by the rule. This is not true, but an initial reading of the SEC's own fact sheet was confusing. Mr. Taft appears to have misinterpreted it.

Ken Bentsen is CEO of Sifma. In a June 13 op-ed, Bentsen writes, "Disclosure of a financial conflict alone also is not considered adequate, effectively holding BDs to a higher standard than the one applicable to RIAs today." This assertion is also not true. It's grossly misleading. But it is a main argument of Reg BI adherents.

The bottom line. Ambiguous and confusing language is misleading.

Four, Reg BI is widely opposed among consumer groups and investment advisers.

The SEC dismisses critics of the rulemaking. Commenters, perhaps, like AARP, Consumer Federation of America, the Investment Advisers Association, CFA Institute, NASAA and the Institute for the Fiduciary Standard that have expressed serious concerns with the proposal and, or final rule. The question of course is do each of these organizations show a "lack of understanding" of the law?

Five, one particularly important provision of the proposal should be maintained and not eliminated.

50.104(3)a(5) *"*Have a reasonable basis to believe that prior to or at the time of the recommendation the retail investor has been reasonably informed of the basis of the recommendation and the potential risks, rewards, and costs associated with the recommendation." This requirement is fair, reasonable, important and simple commonsense. It should be welcomed by any firm seeking to demonstrate its alignment with customers. That it is opposed by the industry says much about the industry.

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Conclusion

The Reg BI release shows how Reg BI is a suitability-like rule and why it seems it will be enforced as one. Yet, it's branded a "higher standard" than RIA's fiduciary standard. This dis-function between what Reg BI is and what Reg BI advocates say it is has created a divide that separates Reg BI adherents and fiduciary advocates into opposing camps that seem to not hear, acknowledge, and comprehend almost any substantive points alike. Basic words or terms such as "fee disclosure," and "mitigation" have different meanings.

Industry and regulatory leadership that is based on a real best interest standard, as opposed to a vague and undefined standard that will be defined by BDs, is essential to mending divisions and restoring trust and confidence in the markets and the finance industry. Thank you for your efforts to do so.

Sincerely,

Knut A. Rostad
Knut A. Rostad
President