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The Honorable Allison Herren Lee
Acting Chair
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Regulation Best Interest 2.0: A Short Manifesto for Improving Investor Protection

Dear Acting Chair Lee:

We are writing to follow up on our recent conversation with you and your staff regarding desired changes and adjustments needed to the Securities and Exchange Commission's (the "Commission") Regulation Best Interest ("Reg. BI"). The suggested changes enclosed herewith reflect concerns that CFA Institute and others have collectively expressed about the final rule, including whether it has adequately addressed concerns about mis-selling of financial products, transparency of broker-dealers' conflicts of interest and financial incentives, and basic investor protections. We appreciate the opportunity to deliver our "Reg. BI 2.0: A Short Manifesto for Investor Protection" for the Commission's consideration, as it sorts through potential changes.

Introduction

In short, Regulation Best Interest has fallen far short of the vision and expectations initially intended in the pursuit to mitigate mis-selling of financial products and services that has existed for many years and was magnified by the Great Financial Crisis. It has failed to deliver on the promise of bringing clarity and consistency to the standard of conduct of broker-dealer firms and their registered representatives when providing advice to retail investors. So too has Reg. BI failed to meet the Congressional mandate under the Dodd-Frank Act. It was a financial crisis of different origins and nuances than our current predicament that gave rise to the regulatory effort to address mis-selling of financial products and services. Yet here we are more than a decade later having done little more than produce new labels for the same level of brokerage services and responsibilities.

As an organization of investment professionals committed to investor protection, CFA Institute[1] has long advocated for a fiduciary duty standard that would apply uniformly to all who provide

[1] CFA Institute is a global, not-for-profit professional association with more than 80,000 U.S.- based investment professionals affiliated with our 67 CFA local societies in the United States. Worldwide, CFA Institute membership includes more than 185,400 investment analysts, advisers, portfolio managers, and other investment professionals in 163 countries, of whom more than 178,500 hold the Chartered Financial Analyst® (CFA®) designation.

personalized investment advice to retail investors. With this letter, we respectfully encourage the Commission take up a directed effort to elevate the inadequate improvements offered by Reg. BI to meaningful, investor-focused protections. We present below our summary observations and recommendations regarding Reg. BI and Form CRS Relationship Summary ("Form CRS").

Observations and Recommendations for Reg. BI 2.0

Definition of Best Interest

- At this late date, a formal and clear definition of "best interest," the hallmark of Reg. BI, does not exist. The Commission should adopt a definition to enhance investor protection.
- We understand many registered representatives are misusing the "I work in your best interest" mantra to suggest they are a fiduciary or a personal investment advisor of the customer.
- The books and records obligations and documentation required of various investment recommendations and how they meet the "best interest" of the customer are a bit of a mystery. We are concerned that vague and variable recordkeeping practices across firms and registered representatives will lead to inconsistent and less diligent compliance behavior.

Form CRS

- Form CRS may well be the least effective form ever created by the Commission, in terms of matching stated objectives with the actual level of comprehension and helpfulness provided to retail investors.
- A clear explanation of the duties owed by a broker/salesperson to a brokerage customer is at best vague and likely ignored or not understood by potential customers.
- Form CRS does not specifically require what we consider to be an extremely important and necessary comparison of the duties the registered representative owes to others vs the customer. Of note is the duty the registered representative owes to the issuer of the securities being sold to the customer. In our view, this features as a primary and unacknowledged duty eclipsing customers' best interests. This should be explained to the customer in Form CRS.
- The "agency issue" should be disclosed at the time of account initiation with a requirement for periodic reminders, which, as a practical matter, should occur as part of subsequent point-of-sale activities with the customer. This is the only means of transparency, clarity, and understandability of the inherent conflicts of interest that exist in the relationship.
- In the longer term, we would urge the Commission to embark on a holistic review and testing of customer relationship disclosures. Such a review should emphasize a layered approach, taking advantage of flexibility afforded by the customer relationship document, and, in contrast to the Adopting Release, consider requirements for "point-of-sale" disclosures of specific conflicts arising in the context of each particular transaction.

Improving FAQs

The below suggestions are offered as improvements to the FAQs regarding issues likely to come up from brokerage firms and/or questions that will need addressing during regulator examinations of broker-dealers.

General Disclosure Obligations. Under the Reg. BI Disclosure Obligation, a registered representative must provide full and fair disclosure of all material facts about the scope and terms of its relationship with a customer. The Adopting Release notes that "[t]he Disclosure Obligation requires the disclosure of *all* material facts related to the scope and terms of the relationship with the retail customer. The material facts identified in Regulation Best Interest are the minimum of what must be disclosed" (emphasis ours). The Adopting Release also notes that "broker-dealers and such associated persons thus will need to consider, based on the facts and circumstances, whether there are other material facts relating to the scope and terms of the relationship with the retail customer that need to be disclosed." In addition to the foregoing, the Disclosure Obligation requires broker-dealers and such associated persons to fully and fairly disclose material facts relating to conflicts of interest that are associated with the recommendation.

At the same time, however, the Adopting Release notes that unlike disclosure required of investment advisers, "the Disclosure Obligation [of broker-dealers] *only* requires disclosure of material facts relating to the *scope and terms* of the relationship with the broker-dealer, and material facts relating to conflicts of interest associated with a broker-dealer's recommendations, and not of all material facts relating to the relationship" (emphasis ours).

The question arises, are there other material facts related to the relationship that fall outside the scope of the outlined categories? For example: With respect to securities offerings, does the Disclosure Obligation require broker-dealers and associated persons to disclose the following:

- That the broker-dealer acts as an agent for the issuer in addition to the retail customer.
- That the broker-dealer's primary role in an offering is to offer and sell the issuer's securities on behalf of the issuer.
- That the broker-dealer's compensation is determined by, and paid by, the issuer and not the customer.
- That the registered representative is compensated only if their sales efforts on behalf of the issuer are successful.
- The broker-dealer's sales activity is dictated by the issuer via a selling agreement entered into with the issuer or another agent of the issuer (such as the principal underwriter or wholesaler).
- That, because of the foregoing, the registered representative owes a duty of care and loyalty to the issuer whose interests are not aligned with those of the retail customer.
- That under the law, the registered representative's recommendation to the customer is solely incidental to the brokerage services provided; and

- That the registered representative is not paid for the recommendation or other advice it provides to the retail customer but rather for its (successful) sales efforts conducted on behalf of the issuer.

The Adopting Release states that the Commission is "not requiring that information regarding conflicts be disclosed on a recommendation-by-recommendation basis." We think this is a prime example of industry capture in this rulemaking, one that discounts the need for a continuous reminder and acknowledgement to the customer that conflicts exist and that the registered representatives' duties are often divided. As stated, this seems to suggest a one-and-done approach to conflict disclosures. Consider how ineffective this becomes as an investor protection matter where a registered representative provides the disclosure required under the Disclosure Obligation in connection with a recommendation made to a retail customer and then makes a second recommendation to the same retail customer a short period of time (a few days or weeks) thereafter.

Care Obligation

- How can a registered representative demonstrate that its recommendations do not place the financial or other interest of the broker-dealer/associated person ahead of the customer's interest under the Care Obligation (as opposed to the General Best Interest Obligation in Section II.A, General Obligation of the rule)?
- Can the Commission Staff elaborate (beyond what is in the Adopting Release) on what are "reasonably available alternatives" (RAA)? Can the Staff provide situational examples? What are Staff recommendations for best practices on documenting and reviewing RAAs?

Conflict of Interest Obligation

With respect to a broker-dealer's obligation to identify and eliminate sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period:

- Can the Staff further clarify the phrase "specific types of securities"?
- Can the Staff further clarify the phrase "limited period of time"?
- Can the Staff elaborate (beyond what is in the Adopting Release) on how broker-dealers can determine if they have done enough to mitigate conflicts of interest associated with recommendations that create an incentive for a natural person who is an associated person of a broker-dealer to place the interest of the broker-dealer, or such natural person, ahead of the interest of the retail customer?

Additional specific FAQs

- What is, or should be, required from the registered representative for clarity of the "I am a salesperson vs. your personal financial adviser."
- When and how often must a registered representative remind the customer of these agency issues? (Note: Reg. BI documents often "hint" at this but it is not required. If it becomes required in the first place, Form CRS could solve this.)

- What sort of documentation must a broker-dealer be able to produce regarding conflict disclosures? (Note: Reg. BI seems to require recordkeeping of each transaction – but no explanation or direction on how much detail to document on, for example, any revenue sharing arrangements with the fund sponsor, or on selling a higher priced product that is still deemed in the best interest of the customer or the basis of such recommendation.)
- What disclosures are needed regarding primary offerings of things like IPOs; real estate funds; unit investment trusts (UITs); mutual funds; exchange-traded funds (ETFs); fixed income securities; digital assets; SPACs; or other products considered to be in continuous offering (i.e. the registered representative and their firm are the selling agents for the issuer – they are first and foremost obligated to the issuer)? (Note: Staff should assess where the brokerage firm and registered representative now make most of their revenue in the current evolution of brokerage services featuring no fee, no commission accounts. Does this revenue source of issuer paid inducements now represent the bulk of brokerage firm revenue and where potential mis-selling concerns are now heightened?)

Conclusion

As Reg. BI is still in its early days, it is important in our view that the Commission continue to substantively address what are clear deficiencies and gaps in the disclosures and procedures established by the new regulation. By providing more specificity and clarity around the general obligations for disclosure, care, conflicts of interest, and compliance, the ongoing implementation of Reg. BI will improve and avoid inconsistencies in practice and application. Such clarity is needed to curb mis-selling effectively and to raise the standards of conduct for the benefit of practitioners and investors alike.

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On behalf of CFA Institute, we thank you for your consideration and welcome the opportunity to discuss our letter with you. Please do not hesitate to contact us.

Sincerely,

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cc: The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
Christian Sabella, Acting Director, Division of Trading and Markets
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Robert W. Cook, President and CEO, Financial Industry Regulatory Authority

The Honorable Sherrod Brown, Chairman, Committee on Banking, Housing & Urban Affairs, United States Senate
The Honorable Pat Toomey, Ranking Member, Committee on Banking, Housing & Urban Affairs, United States Senate
The Honorable Maxine Waters, Chairwoman, Committee on Financial Services, United States House of Representatives
The Honorable Patrick T. McHenry, Ranking Member, Committee on Financial Services, United States House of Representatives