Morgan Lewis

SEC PROPOSED STANDARDS OF CONDUCT FOR RETAIL ADVICE

Morgan Lewis

table of contents

TAB 1

recommendations to retail customers and could impose lower compliance costs on broker-dealers, including small entities, relative to the requirements of the proposed rule. This approach would also reflect an approach that is even more performance-based than the current proposal, as it would be less prescriptive.

For the reasons described in this Section VI. above and in Section IV.E., the Commission preliminarily believes that any regulatory approach should provide a clear understanding of what a best interest standard would entail to a level set across broker-dealers and that a principles-based standard of conduct approach only, would be less effective from a retail customer protection standpoint than proposed Regulation Best Interest.[723] Further, we preliminarily believe that a principles-based approach could increase liability costs for broker-dealers, including small entities, as a result of lack of clarity in the standard.

3. Enhanced Standards Akin to BIC Exemption

The Commission could alternatively propose a fiduciary standard coupled with a series of disclosure and other requirements akin to the full complement of conditions of the DOL's BIC Exemption, which would apply to broker-dealers (including small entities) when making investment recommendations to all types of retail accounts rather than only in connection with services to retirement accounts.[724]

We recognize that there could be reduced economic effects for broker-dealers (including small entities) that may already have established infrastructure for purposes of the DOL's BIC Exemption. However, an alternative that would impose upon broker-dealers a fiduciary standard coupled with a set of requirements akin to the BIC Exemption conditions could drive up costs to retail customers of obtaining investment advice from broker-dealers, and could cause some retail customers to forgo advisory services through broker-dealers if they were priced out of the market.[725]

As a result, and for a number of other reasons described above, the Commission preliminarily believes that requiring broker-dealers to comply with a fiduciary standard coupled with a set of requirements akin to the full complement of conditions under the BIC Exemption could impose costs to broker-dealers (including small entities) and impact retail customers and the market for investment advice, and would not be entirely consistent with the regulatory approach of the Commission.[726]

G. General Request for Comment

For the foregoing reasons, the Commission preliminarily believes that Regulation Best Interest might have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission encourages written comments regarding this initial regulatory flexibility analysis. The Commission specifically solicits comment on the number of small entities that may be affected by Regulation Best Interest, and whether Regulation Best Interest would have an effect on small entities that has not been considered. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact. We also request comment on the proposed compliance burdens and the effects these burdens would have on smaller entities.

VIII. Statutory Authority and Text of Proposed Rule

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act Section 913(f), Public Law 111–203, 124 Stat. 1376, 1827 (2010), and Exchange Act sections 3, 10, 15, 17, 23 and 36 thereof, 15 U.S.C. 78c, 78j, 78o, 78q, 78w and 78mm, the Commission is proposing to adopt § 240.15*l*–1, to amend § 240.17a–3 by adding new paragraph (a)(25), and to revise § 240.17a–4(e)(5) of Title 17 of the Code of Federal Regulations in the manner set forth below.

List of Subjects in 17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

Text of the Proposed Rules

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The general authority citation for part 240 continues to read as follows and sectional authorities for section 240.15*l*–1 are added to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c–3, 78c–5, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78n–1, 78o, 78o–4, 78o–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78dd, 78ll, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, 7201 *et seq.,* and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111–203, 939A, 124 Stat. 1887 (2010); and secs. 503 and 602, Pub. L. 112–106, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

Section 240.15*l*–1 is also issued under Pub. L. 111–203, sec. 913, 124 Stat. 1376, 1827 (2010).

* * * * *

■ 2. Add § 240.15*l*–1 to read as follows:

§ 240.15*l*–1 Regulation Best Interest.

(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 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.

(2) The best interest obligation in paragraph (a)(1) shall be satisfied if:

(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 such recommendation, reasonably discloses to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer, including all material conflicts of interest that are associated with the recommendation.

(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, skill, and prudence to:

(A) Understand the potential risks and rewards 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 and rewards associated with the recommendation; and

(C) Have a reasonable basis to believe that a series of recommended transactions, even if in the retail

[723] *See supra* Section IV.E.

[724] *Id.*

[725] *See, e.g.,* note 75 *supra,* and accompanying text. *But see,* notes 76–77, and accompanying text.

[726] *Id.*

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.

(iii) *Conflict of Interest Obligations.*

(A) The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendations.

(B) The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.

(b) *Definitions.* Unless otherwise provided, all terms used in this rule shall have the same meaning as in the [Securities Exchange Act of 1934]. In addition, the following definitions shall apply:

(1) *Retail Customer* means a person, or the legal representative of such person, who: (A) 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

(B) Uses the recommendation primarily for personal, family, or household purposes.

(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.

■ 3. Amend § 240.17a-3 by adding new paragraph (a)(25) to read as follows:

§ 240.17a–3 Records to be made by certain exchange members, brokers and dealers.

(a) * * *

(25) For each retail customer to whom a recommendation of any securities transaction or investment strategy involving securities is or will be provided:

(i) A record of all information collected from and provided to the retail customer pursuant to § 240.15*l*–1, as well as the identity of each natural person who is an associated person, if any, responsible for the account.

(ii) For purposes of this paragraph (a)(25), the neglect, refusal, or inability of the retail customer to provide or update any information required under paragraph (a)(25)(i) of this section shall excuse the broker, dealer, or associated person from obtaining that required information.

* * * * *

■ 4. Amend § 240.17a–4 by revising paragraph (e)(5) to read as follows:

§ 240.17a–4 Records to be preserved by certain exchange members, brokers and dealers.

* * * * *

(e) * * *

(5) All account record information required pursuant to § 240.17a–3(a)(17) and all records required pursuant to § 240.17a–3(a)(25), in each case until at least six years after the earlier of the date the account was closed or the date on which the information was collected, provided, replaced, or updated.

* * * * *

By the Commission.

Dated: April 18, 2018.

Brent J. Fields,

Secretary.

[FR Doc. 2018–08582 Filed 5–8–18; 8:45 am]

BILLING CODE 8011–01–P

TAB 2

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–83062; File No. S7–07–18]

RIN 3235–AM35

Regulation Best Interest

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing a new rule under the Securities Exchange Act of 1934 (''Exchange Act'') establishing a standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer.

DATES: Comments should be received on or before August 7, 2018.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number S7–07–18 on the subject line.

Paper Comments

- Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7–07–18. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (*http://www.sec.gov/rules/proposed.shtml*). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make publicly available.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Lourdes Gonzalez, Assistant Chief Counsel—Office of Sales Practices; Emily Westerberg Russell, Senior Special Counsel; Alicia Goldin, Senior Special Counsel; Bradford Bartels, Special Counsel; Geeta Dhingra, Special Counsel; and Stacy Puente, Special Counsel, Office of Chief Counsel, Division of Trading and Markets, at (202) 551–5550, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–8549.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Introduction

Broker-dealers play an important role in helping Americans organize their financial lives, accumulate and manage retirement savings, and invest toward other important long-term goals, such as buying a house or funding a child's college education. Broker-dealers may offer a wide variety of brokerage (*i.e.,* agency) services to retail customers ranging from providing customers with execution-only services (*e.g.,* discount brokerage), which typically does not involve advice, to providing a range of services, including advice, to customers (*i.e.,* full-service brokerage).[1] Broker-dealers are typically considered to provide advice when they make recommendations of securities transactions or investment strategies involving securities to customers.[2] Broker-dealers also may offer a variety of dealer (*i.e.,* principal) services and investment products to retail customers,[3] and may make recommendations to retail customers about such principal services, such as recommending transactions where the broker-dealer is buying securities from or selling securities to retail customers on a principal basis or recommending proprietary products.[4] Like many principal-agent relationships, the relationship between a broker-dealer and an investor has inherent conflicts of interest, which may provide an incentive to a broker-dealer to seek to maximize its compensation at the expense of the investor it is advising. As we discuss below, concerns regarding the potential harm to retail customers resulting from broker-dealer conflicts of interest, and in particular the conflicts associated with financial incentives, have existed for some time.

The rule we are proposing today addresses the question of whether changes should be made to the standard of conduct that applies to broker-dealers when making recommendations about securities to retail customers. As discussed below, broker-dealers are subject to regulation under the Exchange Act and the rules of each self-regulatory organization (''SRO'') of which the broker-dealer is a member,[5] including a number of obligations that attach when a broker-dealer makes a recommendation to a customer, as well as general and specific requirements aimed at addressing certain conflicts of interest. These obligations have developed in response to and reflect the unique structure and characteristics of the broker-dealer relationship with retail customers—in particular, the compensation and other conflicts presented, the variety in the frequency and level of advice services provided (*i.e.,* one-time, episodic or on a more frequent basis), and the spectrum of services provided to retail customers that may or may not include advice (such as executing unsolicited transactions). While these obligations are extensive, there is no specific obligation under the Exchange Act that broker-dealers make recommendations that are in their customers' best interest.[6]

After extensive consideration of these issues, we believe it is appropriate to make enhancements to the obligations that apply when broker-dealers make recommendations to retail customers. Accordingly, we are proposing a new rule under the Exchange Act that would establish an express best interest obligation: That all broker-dealers and natural persons who are associated persons of a broker-dealer (unless otherwise indicated, together referred to as ''broker-dealer''), when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer, 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 making the recommendation ahead of the interest of the retail customer (''Regulation Best Interest''). The proposed rule would provide that the best interest obligation shall be satisfied if:

- 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, reasonably discloses to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer and all material conflicts of interest that are associated with the recommendation;
- The broker-dealer or natural person who is an associated person of a broker or dealer, in making the recommendation, exercises reasonable diligence, care, skill, and prudence to: (1) Understand the potential risks and rewards 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; (2) 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 and rewards associated with the recommendation; and (3) 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;
- The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendations; and
- The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.

Regulation Best Interest is designed to make it clear that a broker-dealer may not put her or her firm's financial interests ahead of the interests of her retail customer in making investment recommendations. Our goal in designing proposed Regulation Best Interest is to enhance investor protection, while preserving, to the extent possible, access and choice for investors who prefer the ''pay as you go'' model for advice from broker-dealers, as well as preserve retail customer choice of the level and types of advice provided and the products available. We believe that the proposed best interest obligation for broker-

[1] Such ''agency'' services may include, but are not limited to: Providing transaction-specific recommendations to buy or sell securities for commissions; providing asset allocation services with recommendations about asset classes, specific sectors, or specific securities; providing generalized research, advice, and education; providing custody and trade execution to a customer who has selected an independent investment manager or other money manager; executing trades placed by investment advisers in wrap fee programs; offering margin accounts; and operating a call center (*e.g.,* responding to a customer request for stock quotes, information about an issuer or industry, and then placing a trade at the customer's request). *See, e.g.,* Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) (''913 Study''), at 9–10, *available at www.sec.gov/news/studies/2011/913studyfinal.pdf.*

[2] *See* 913 Study at 124.

[3] As the Staff noted in the 913 Study, such ''dealer'' services may include, but are not limited to: Selling securities (such as bonds) out of inventory; buying securities from customers; selling proprietary products (*e.g.,* products such as affiliated mutual funds, structured products, private equity and other alternative investments); selling initial and follow-on public offerings; selling other underwritten offerings; acting as principal in Individual Retirement Accounts (''IRAs''); acting as a market maker; and otherwise acting as a dealer. Broker-dealers may offer solely proprietary products, a limited range of products, or a diverse range of products. *Id.* at 10.

[4] *Id.* at 13.

[5] Generally, all registered broker-dealers that deal with the public must become members of the Financial Industry Regulatory Authority (''FINRA''), a registered national securities association, and may choose to become exchange members. *See* Exchange Act Section 15(b)(8) and Exchange Act Rule 15b9–1. FINRA is the sole national securities association registered with the SEC under Section 15A of the Exchange Act. Accordingly, for purposes of discussing a broker-dealer's regulatory requirements when providing advice, we focus on FINRA's regulation, examination and enforcement with respect to member broker-dealers.

[6] As discussed *infra* note 15, FINRA and a number of cases have interpreted FINRA's suitability rule as requiring a broker-dealer to make recommendations that are ''consistent with his customers' best interests'' or are not ''clearly contrary to the best interest of the customer,'' but this is not an explicit requirement of FINRA's suitability rule.

dealers set forth in Regulation Best Interest achieves this goal.

Specifically, we believe that proposed Regulation Best Interest will improve investor protection by enhancing the professional standards of conduct that currently apply to broker-dealers when they make recommendations to retail customers, in four key respects.

• First, it would enhance the quality of recommendations provided by requiring broker-dealers make recommendations in the retail customer's ''best interest,'' which incorporates and goes beyond a broker-dealer's existing suitability obligations under the federal securities laws, and could not be satisfied through disclosure alone.[7]

• Second, it would establish obligations under the Exchange Act that do not rely on disclosure alone as the solution to conflicts arising from financial incentives—including conflicts associated with broker-dealer compensation incentives, the sale of proprietary products, and effecting transactions in a principal capacity.

• Third, it would improve disclosure about the scope and terms of the broker-dealer's relationship with the retail customer, which would foster retail customer awareness and understanding of their relationship with the broker-dealer, which aligns with our broader effort to address retail investor confusion through our separate concurrent rulemaking.[8]

• Finally, it would enhance the disclosure of material conflicts of interest and thereby help retail customers evaluate recommendations received from broker-dealers.

Through these enhancements, we preliminarily believe that the best interest obligation will reduce the potential harm to retail customers from recommendations provided in circumstances where conflicts of interest, including those arising from financial incentives, exist while preserving investor access to advice and choice with regard to advice relationships and compensation methods, and is workable for the transaction-based relationship offered by broker-dealers. Specifically, proposed Regulation Best Interest is designed to achieve these enhancements by building upon, and being tailored to, the unique structure and characteristics of the broker-dealer relationship with retail customers and existing regulatory obligations, while taking into consideration and drawing on (to the extent appropriate) the principles of the obligations that apply to investment advice in other contexts. In drawing from these underlying principles, as opposed to adopting identical or uniform obligations, we seek to apply consistent principles across the spectrum of investment advice, and thereby enhance investor protection while preserving investor choice across products and advice models.

We further believe that, through the establishment of a standard of conduct for broker-dealers under the Exchange Act, this proposed approach would foster greater clarity, certainty, and efficiency with respect to broker-dealer standards of conduct. In addition, by drawing from principles that have developed under other regulatory regimes, we seek to establish greater consistency in the level of protection provided across the spectrum of registered investment advice and ease compliance with Regulation Best Interest where these other overlapping regulatory regimes are also applicable.

Before describing proposed Regulation Best Interest, we provide a brief background on this subject, including recent Commission and other regulators' considerations of the issues involved, the evolution of our perspective on this subject, and our general objectives in proposing Regulation Best Interest.

A. Background

As noted, broker-dealers are subject to comprehensive regulation under the Exchange Act and SRO rules, and a number of obligations attach when a broker-dealer makes a recommendation to a customer. Under the federal securities laws and SRO rules, broker-dealers have a duty of fair dealing,[9] which, among other things, requires broker-dealers to make only suitable recommendations to customers [10] and to receive only fair and reasonable compensation.[11] Broker-dealers are also subject to general and specific requirements aimed at addressing certain conflicts of interest, including

[7] As discussed herein, some of the enhancements that Regulation Best Interest would make to existing suitability obligations under the federal securities laws, such as the collection of information requirement related to a customer's investment profile, the inability to disclose away a broker-dealer's suitability obligation, and a requirement to make recommendations that are ''consistent with his customers' best interests,'' reflect obligations that already exist under the FINRA suitability rule or have been articulated in related FINRA interpretations and case law. *See infra* Sections II.D and IV.D, and note 15. Unless otherwise indicated, our discussion of how Regulation Best Interest compares with existing suitability obligations focuses on what is currently required under the Exchange Act.

[8] As discussed in more detail in Section II.D.1 in a separate, concurrent rulemaking, we propose to: (1) Require broker-dealers and investment advisers to deliver to retail investors a short (*i.e.,* four page or equivalent limit if in electronic format) relationship summary; (2) restrict broker-dealers and associated natural persons of broker-dealers, when communicating with a retail investor, from using as part of a name or title the term ''adviser'' or ''advisor'' in certain circumstances; and (3) require broker-dealers and investment advisers, and their associated natural persons and supervised persons, respectively, to disclose in retail investor communications the firm's registration status with the Commission and an associated natural person's and supervised person's relationship with the firm. *See Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles,* Release No. 34–83063, IA–4888, File No. S7–08–18 (''Relationship Summary Proposal'').

[9] *See Report of the Special Study of Securities Markets of the Securities and Exchange Commission,* H.R. Doc. No. 88–95, at 238 (1st Sess. 1963); *In re Richard N. Cea, et al.,* Exchange Act Release No. 8662 at 18 (Aug. 6, 1969) (Commission opinion involving excessive trading and recommendations of speculative securities without a reasonable basis); *In re Mac Robbins & Co. Inc.,* Exchange Act Release No. 6846, 41 SEC. 116 (July 11, 1962); *see also* FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) (requiring a member, in the conduct of its business, to observe high standards of commercial honor and just and equitable principles of trade).

[10] *See Richard N. Cea,* Exchange Act Release No. 8662; *F.J. Kaufman and Co.,* Securities Exchange Act Release No. 27535 (Dec. 13, 1989); FINRA Rule 2111.01 (Suitability) (''Implicit in all member and associated person relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of [FINRA's] Rules, with particular emphasis on the requirement to deal fairly with the public. The suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct.''). *See also* 913 Study at 51–53, 59; *A Joint Report of the SEC and the CFTC on Harmonization of Regulation* (Oct. 2009), *available at http://www.sec.gov/news/press/2009/cftcjointreport101609.pdf,* at 61–64.

[11] *See, e.g.,* FINRA Rules 2121 (Fair Prices and Commissions), 2122 (Charges for Services Performed), and 2341 (Investment Company Securities). *See also* Exchange Act Sections 10(b) and 15(c).

requirements to eliminate,[12] mitigate,[13] or disclose certain conflicts of interest.[14]

Despite the breadth of a broker-dealer's existing conduct obligations, broker-dealers are not explicitly required to make recommendations that are in a customer's ''best interest.'' [15] Like many principal-agent relationships, the relationship between a broker-dealer and a retail customer has certain inherent and unavoidable conflicts of interest.[16] For example, as a result of transaction-based compensation structures, broker-dealers often make recommendations to retail customers against a backdrop of potential conflicts that may provide them with an incentive to seek to increase their compensation at the expense of the investors they are advising. In addition, other conflicts of interest arise out of business activities that broker-dealers may choose to engage in (including, among others, receipt of third-party compensation, principal trading, and the sale of proprietary or affiliated products). The Commission believes that material conflicts of interest associated with the broker-dealer relationship need to be well understood by the retail customer and, in some cases, mitigated or eliminated.[17]

In this regard, it has been asserted that (1) retail customers do not sufficiently understand the broker-dealer relationship, and in particular the conflicts presented by broker-dealer compensation arrangements and practices when making a recommendation, and (2) regardless of the sufficiency of the retail customer's understanding of the broker-dealer structure, broker-dealer regulatory requirements do not require a broker-dealer's recommendations to be in a customer's best interest and require limited disclosure that may not appropriately address the conflicts of interest presented.[18]

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[12] For example, FINRA rules establish restrictions on the use of non-cash compensation in connection with the sale and distribution of mutual funds, variable annuities, direct participation program securities, public offerings of debt and equity securities, and real estate investment trust programs. These rules generally limit the manner in which members can pay or accept non-cash compensation and detail the types of non-cash compensation that are permissible. *See* FINRA Rules 2310, 2320, 2331, and 5110.

[13] *See, e.g.,* FINRA Rule 3110(c)(3) (firm must have procedures to prevent the effectiveness of an internal inspection from being compromised due to conflicts of interest); FINRA Rule 3110(b)(6)(C) (supervisory personnel generally cannot supervise their own activities); FINRA Rule 3110(b)(6)(D) (firm must have procedures reasonably designed to prevent the required supervisory system from being compromised due to conflicts of interest). Further, a broker-dealer may recommend a security even when a conflict of interest is present, but that recommendation must be suitable. *See* FINRA Rule 2111. The antifraud provisions of the federal securities laws and the implied obligation of fair dealing prohibit a broker-dealer from, among other things, making unsuitable recommendations and may impose liability on broker-dealers that do not investigate an issuer before recommending the issuer's securities to a customer. *See, e.g., Hanly* v. *SEC,* 415 F.2d 589, 596 (2d Cir. 1969). *See also Municipal Securities Disclosure,* Exchange Act Release No. 26100, at n. 75 (Sept. 22, 1988). The fair dealing obligation also requires a broker-dealer to reasonably believe that its securities recommendations are suitable for its customer in light of the customer's financial needs, objectives and circumstances (customer-specific suitability). *See Richard N. Cea,* Exchange Act Release No. 8662, at 18 (involving excessive trading and recommendations of speculative securities without a reasonable basis).

[14] A broker-dealer may be liable if it does not disclose ''material adverse facts of which it is aware.'' *See, e.g., Chasins* v. *Smith, Barney & Co.,* 438 F.2d 1167, 1172 (2d Cir. 1970); *SEC* v. *Hasho,* 784 F. Supp. 1059, 1110 (S.D.N.Y. 1992). For example, when engaging in transactions directly with customers on a principal basis, a broker-dealer violates Exchange Act Rule 10b–5 when it knowingly or recklessly sells a security to a customer at a price not reasonably related to the prevailing market price and charges excessive markups (as discussed above), without disclosing the fact to the customer. *See, e.g., Grandon* v. *Merrill Lynch & Co.,* 147 F.3d 184, 189–90 (2d Cir. 1998). *See also* Exchange Act Rule 10b–10 (requiring a broker-dealer effecting transactions in securities to provide written notice to the customer of certain information specific to the transaction at or before completion of the transaction, including the capacity in which the broker-dealer is acting (*i.e.,* agent or principal) and any third-party remuneration it has received or will receive).

[15] While not an explicit requirement of FINRA's suitability rule, FINRA and a number of cases have interpreted the suitability rule as requiring a broker-dealer to make recommendations that are ''consistent with his customers' best interests'' or are not ''clearly contrary to the best interest of the customer.'' *See, e.g., In re Application of Raghavan Sathianathan,* Exchange Act Release No. 54722 at 21 (Nov. 8, 2006); *In re Application of Dane S. Faber,* Exchange Act Release No. 49216 at 23–24 (Feb. 10, 2004); *In re Powell & McGowan, Inc.,* Exchange Act Release No. 7302 (Apr. 24, 1964). In interpretive guidance, FINRA has stated that ''[t]he suitability requirement that a broker make only those recommendations that are consistent with the customer's best interests prohibits a broker from placing his or her interests ahead of the customer's interests.'' *See* FINRA Regulatory Notice 12–25, Additional Guidance on FINRA's New Suitability Rule (May 2012) (''FINRA Regulatory Notice 12–25'').

In addition, a broker-dealer may have a fiduciary duty under certain circumstances. This duty may arise under state common law, which varies by state. Generally, courts have found that broker-dealers that exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers, are found to owe customers a fiduciary duty similar to that of investment advisers. *See, e.g., United States* v. *Skelly,* 442 F.3d 94, 98 (2d Cir. 2006); *United States* v. *Szur,* 289 F.3d 200, 211 (2d Cir. 2002); *Associated Randall Bank* v. *Griffin, Kubik, Stephens & Thompson, Inc.,* 3 F.3d 208, 212 (7th Cir. 1993); *MidAmerica Fed. Savings & Loan Ass'n* v. *Shearson/American Express Inc.,* 886 F.2d 1249, 1257 (10th Cir. 1989); *Leib* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 461 F. Supp. 951, 953–954 (E.D. Mich. 1978), *aff'd,* 647 F.2d 165 (6th Cir. 1981). *Cf. De Kwiatkowski* v. *Bear, Stearns & Co., Inc.,* 306 F.3d 1293 (2d Cir. 2002) (finding that absent ''special circumstances'' (*i.e.,* circumstances that render the client dependent—a client with impaired faculties, or one who has a closer than arms-length relationship with the broker, or one who is so lacking in sophistication that de facto control of the account is deemed to rest in the broker-dealer), a broker-dealer does not have a duty to give on-going advice between transactions in a non-discretionary account, even if he volunteered advice at times; ''[I]t is uncontested that a broker ordinarily has no duty to monitor a nondiscretionary account, or to give advice to such a customer on an ongoing basis. The broker's duties ordinarily end after each transaction is done, and thus do not include a duty to offer unsolicited information, advice, or warnings concerning the customer's investments. A nondiscretionary customer by definition keeps control over the account and has full responsibility for trading decisions. On a transaction-by-transaction basis, the broker owes duties of diligence and competence in executing the client's trade orders, and is obliged to give honest and complete information when recommending a purchase or sale. The client may enjoy the broker's advice and recommendations with respect to a given trade, but has no legal claim on the broker's ongoing attention.'') (citations omitted).

For the staff's discussion of relevant case law see 913 Study, at 54–55. *See also A Joint Report of the SEC and the CFTC on Harmonization of Regulation* (Oct. 2009), *available at http://www.sec.gov/news/press/2009/cftcjointreport101609.pdf,* at 8–9 and 67. *See also* Section II.F. for a discussion and request for comment regarding broker-dealer exercise of discretion and the extent to which such exercise is ''solely incidental'' to the conduct of its business as a broker-dealer.

[16] *See infra* Section IV.B.1. For instance, in the past, brokerage firms have been fined for placing customers in fee-based brokerage accounts that generated higher fees for the firm, where such accounts were not appropriate for the customer. *See, e.g.,* NASD News Release, NASD Fines Raymond James $750,000 for Fee-Based Account Violations (Apr. 27, 2005), *available at http://www.finra.org/newsroom/2005/nasd-fines-raymond-james-750000-fee-based-account-violations* (finding that Raymond James violated NASD rules by recommending and opening fee-based brokerage accounts for customers without first determining whether the accounts were appropriate and by allowing those accounts to remain open). *See also* NYSE Hearing Board Decision 06–133 (July 10, 2006), *available at https://www.nyse.com/publicdocs/nyse/markets/nyse/disciplinary-actions/2006/06-133.pdf* (finding that A.G. Edwards had wrongfully placed customers into non-managed fee accounts in lieu of commission-based accounts, where non-managed fee-based brokerage accounts were not appropriate for buy-and-hold investors or for investors with few transactions, which resulted in such investors paying substantially more in fees than they would have paid under a commission-based structure); FINRA Press Release, FINRA Fines Robert W. Baird & Co. $500,000 for Fee-Based Account, Breakpoint Violations (Feb. 18, 2009), *available at http://www.finra.org/newsroom/2009/finra-fines-robert-w-baird-co-500000-fee-based-account-breakpoint-violations* (finding that Robert W. Baird & Co. failed to adequately review customer accounts that were transferred into a fee-based brokerage program, allowing numerous customers to remain in the program despite conducting no trades, where the firm continued to receive substantial fees despite inactivity on customers' accounts).

[17] *See infra* Section II.D.3.

[18] *See, e.g.,* Letter from Marnie C. Lambert, President, Public Investors Arbitration Bar Association (Aug. 11, 2017) (''PIABA Letter'') (''The Suitability Rule is not sufficient on its own to remove and manage these conflicts and ensure that brokers have acted in their clients' best interests. . . . Any standards adopted by the SEC

Continued

These concerns are not new. The Commission has previously expressed long-held concerns about the incentives that commission-based compensation provides to churn accounts, recommend unsuitable securities, and engage in aggressive marketing of brokerage services.[19] This apprehension about the potentially harmful effects of conflicts has been reflected over the years in, among other things, our National Examination Program's examination priorities, which have continually included conflicts of interest as an exam focus—either generally or specifically (*e.g.,* the role of conflicts of interest in and suitability of recommendations involving retirement accounts (such as investment or rollover recommendations), complex or structured products, variable annuities, higher yield securities, exchange traded funds, and mutual fund share class selection (*i.e.,* share classes with higher loads or distribution fees))—for many years.[20] As our exam staff has noted, ''[c]onflicts of interest, when not eliminated or properly mitigated and managed, are a leading indicator and cause of significant regulatory issues for individuals, firms and sometimes the entire market.'' [21]

FINRA has similarly focused on the potential risks to broker-dealers and to retail customers presented by broker-dealer conflicts, and impact on brokerage recommendations, as reflected in guidance addressing and highlighting circumstances in which various broker-dealer conflicts of interest may create incentives that are contrary to the interest of retail customers.[22] Most notably, in 2013, FINRA published a report on conflicts of interest in the broker-dealer industry to highlight effective conflicts management practices.[23] At the time of publication of the FINRA Conflicts Report, FINRA Chairman and Chief Executive Officer (''CEO'') Richard Ketchum noted that ''[w]hile many firms have made progress in improving the way they manage conflicts, our review reveals that firms should do more.'' [24] He later observed that ''some firms continue to approach conflict management on a haphazard basis, only implementing an effective supervisory process after a failure event involving customer harm occurs,'' and suggested the development of a best interest standard that includes, among other things, ''a requirement that financial firms establish carefully designed and articulated structures to manage conflicts of interest that arise in their businesses.'' [25] In 2015, FINRA launched a targeted exam regarding incentive structures and conflicts of interest in connection with firms' retail brokerage business, which encompassed firms' conflict mitigation processes regarding compensation plans for registered representatives, and firms' approaches to mitigating conflicts of interest that arise through the sale of proprietary or affiliated products, or products for which a firm receives third-party payments (*e.g.,* revenue sharing).[26]

These concerns about the potential harms that may result from broker-dealer conflicts of interest have been echoed by commenters over the years. Recent commenters' analyses suggest that retail customers have been harmed by conflicted advice, such as the incentives created by broker-dealer compensation arrangements, due to the lack of an explicit ''best interest'' obligation applying to such advice.[27]

At the same time, many retail customers generally and reasonably expect that their investment firms and professionals, including broker-dealers, will—and rely on them to—provide advice that is in their best interest by placing investors' interest before their own. Studies have documented that many retail customers who use the services of broker-dealers and investment advisers are not aware of the differences in regulatory approaches for these entities, and their associated persons, and the differing duties that flow from them.[28] Commenters assert

should acknowledge that conflicts of interest are pervasive throughout the industry and firms will continue to face challenges when trying to balance the interests of their clients with those conflicts. Any standards adopted should require mitigation of conflicts of interest to the extent possible.''); Letter from Kevin R. Keller, Chief Executive Officer, CFP Board, et al., Financial Planning Coalition (Nov. 7, 2017) (''Financial Planning Coalition Letter'') (stating that FINRA's suitability rule ''fails to mandate disclosure of actual or potential conflicts of interest, proscribe appropriate mitigation mechanisms, or require that broker-dealers put the client's interests above their own earned commissions'').

[19] These concerns led former Chairman Arthur Levitt to form the Committee on Compensation Practices to review industry compensation practices, identify actual and perceived conflicts of interest, and identify ''best practices'' to eliminate, reduce, or mitigate these conflicts. *See* Report of the Committee on Compensation Practices (Apr. 10, 1995) (''Tully Report''). The Tully Report observed that although the commission-based compensation system ''works remarkably well for the vast majority of investors,'' conflicts of interest persist that can damage the interest of retail customers, and identified various ''best practices'' for addressing broker-dealer and registered representative compensation-related conflicts, including fee-based brokerage accounts. *Id.* In 2005, the Commission adopted Rule 202(a)(11)–1 under the Advisers Act, the principal purpose of which was to deem broker-dealers offering ''fee-based brokerage accounts'' as not being subject to the Advisers Act. *See Certain Broker-Dealers Deemed Not To Be Investment Advisers,* Exchange Act Release No. 51523 (Apr. 12, 2005) at 8 (''Release 51523'') (adopting rule 202(a)(11)–1 under the Advisers Act). This rule was later vacated by the Court of Appeals for the District of Columbia Circuit. *See Fin. Planning Ass'n* v. *SEC.,* 482 F.3d 481 (D.C. Cir. 2007).

[20] *See* Office of Compliance Inspections and Examinations (''OCIE''), Examination Priorities for 2013 (Feb. 21, 2013), *available at https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2013.pdf* (''2013 Exam Priorities''); OCIE, Examination Priorities for 2014 (Jan. 9, 2014), *available at https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf*; OCIE, Examination Priorities for 2015 (Jan. 13, 2015), *available at https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf*; OCIE, Examination Priorities for 2016 (Jan. 11, 2016), *available at https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2016.pdf*; OCIE, Examination Priorities for 2017 (Jan. 12, 2017), *available at https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf. See also* OCIE Risk Alert, ''Retirement-Targeted Industry Reviews and Examinations Initiative'' (June 22, 2015), *http://www.sec.gov/about/offices/ocie/retirement-targeted-industry-reviews-and-examinations-initiative.pdf*.

[21] 2013 Exam Priorities.

[22] *See, e.g.,* FINRA Regulatory Notice 13–45, Rollovers to Individual Retirement Accounts: FINRA Reminds Firms of Their Responsibilities Concerning IRA Rollovers (Dec. 2013) (''FINRA Regulatory Notice 13–45''), *available at http://www.finra.org/sites/default/files/NoticeDocument/p418695.pdf.* (noting the economic incentive a financial professional has to encourage an investor to roll plan assets into an IRA that he will represent as either a broker-dealer or an investment adviser representative).

[23] *See* FINRA Report on Conflicts of Interest (Oct. 2013), *available at https://www.finra.org/sites/default/files/Industry/p359971.pdf* (''FINRA Conflicts Report'').

[24] *See* Statement from Chairman and CEO Richard G. Ketchum on FINRA's Report on Conflicts of Interest (Oct. 14, 2013), *available at http://www.finra.org/newsroom/2013/statement-chairman-and-ceo-richard-g-ketchum-finras-report-conflicts-interest*.

[25] *See* Richard G. Ketchum, Remarks From the 2015 FINRA Annual Conference (May 27, 2015), *available at https://www.finra.org/newsroom/speeches/052715-remarks-2015-finra-annual-conference.*

[26] *See* FINRA 2016 Regulatory and Examination Priorities Letter (Jan. 5, 2016), *available at http://www.finra.org/sites/default/files/2016-regulatory-and-examination-priorities-letter.pdf. See also* Conflicts of Interest Review—Compensation and Oversight (Apr. 2015), *available at http://www.finra.org/industry/conflicts-interest-review-compensation-and-oversight*.

[27] *See, e.g.,* Letter from Monique Morrissey, Ph.D., Economist, and Heidi Shierholz, Economist and Director of Policy; Economic Policy Institute (Oct. 5, 2017) (''Economic Policy Institute Letter''); Letter from Americans for Financial Reform (Sept. 22, 2017) (''AFR Letter''); Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America (''CFA'') (Sept. 14, 2017) (''CFA 2017 Letter''); PIABA Letter (''Conflicted advice causes substantial harm to investors. Just looking at retirement savers, *SaveOurRetirement.com* estimates that investors lose between $57 million and $117 million every day due to conflicted investment advice, amounting to at least $21 billion annually.'')

[28] In 2006, the SEC retained the RAND Corporation's Institute for Civil Justice (''RAND'') to conduct a survey, which concluded that the distinctions between investment advisers and broker-dealers have become blurred, and that

that any confusion regarding the standards of conduct that apply may only enhance the potential for harm from broker-dealer conflicts of interest, as this confusion results in retail customers mistakenly relying on those recommendations as being in their ''best interest.'' [29] Commenters have further observed that having differing standards apply to the advice broker-dealers provide, in particular with respect to advice provided to retirement versus non-retirement assets, will create different levels of advice depending on the type of account and will only further this investor confusion.[30]

There is broad acknowledgement of the benefits of, and support for, the continuing existence of the broker-dealer model as an option for retail customers seeking investment advice, notwithstanding the concerns regarding broker-dealer conflicts (including the transaction-based compensation model) and retail customer confusion regarding these conflicts and the limits of the applicable regulations.[31] Among other things, the Commission and our staff, commenters and others have recognized the benefits of the broker-dealer model for advice and the access to advice and the choice of products, services and payment options, that the brokerage model provides retail customers.[32] Moreover, the Commission is aware that certain conflicts of interest are inherent in other principal-agent relationships.[33] The issue at hand, therefore, is how we should address these concerns in a manner that both improves investor protection and preserves these beneficial characteristics—in particular choice regarding access to a variety of products and advice relationships.

1. Evaluation of Standards of Conduct Applicable to Investment Advice

The Commission and its staff have been evaluating the standards applicable to investment advice for some time. In the past, the Commission observed that the lines between full-service broker-dealers and investment advisers have blurred, and expressed concern when specific regulatory obligations depend on the statute under which a financial intermediary is registered instead of the services provided.[34] At the same time, we acknowledged that the Exchange Act, the rules thereunder, and SRO rules provide substantial protections for broker-dealer customers, and expressed that we did not believe that requiring most or all full-service broker-dealers to treat most or all of their customer accounts as advisory accounts would be an appropriate response to this blurring.[35]

In 2011, the Commission staff issued the 913 Study, which was mandated by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the ''Dodd-Frank Act''), in which they made recommendations to the Commission that the staff believed would enhance retail customer protections and decrease retail customers' confusion about the standard of conduct owed to them when their financial intermediary provided them personalized investment advice.[36] One of the staff's primary recommendations was that the Commission engage in rulemaking to adopt and implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. The staff's recommended standard would require firms ''to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer or investment adviser providing the advice.'' [37]

The staff made a number of specific recommendations for implementing the uniform fiduciary standard of conduct, including that the Commission should: (1) Require firms to eliminate or disclose conflicts of interest; (2) consider whether rulemaking would be appropriate to prohibit certain conflicts, to require firms to mitigate conflicts through specific action, or to impose specific disclosure and consent requirements; and (3) consider specifying uniform standards for the duty of care owed to retail customers, such as specifying what basis a broker-dealer or investment adviser should have in making a recommendation to a retail customer by referring to and expanding upon broker-dealers' existing suitability requirements.[38]

The staff explained that the recommendations were intended to, among other things, heighten investor protection, address retail customer confusion about the obligations broker-dealers and investment advisers owe to those customers, and preserve retail customer choice without decreasing retail customers' access to existing products, services, service providers, or compensation structures.[39]

Following the 913 Study, in 2013 the Commission issued a request for information (''Request'') seeking additional information from the public to assist the Commission in evaluating whether and how to address certain standards of conduct for, and regulatory obligations of, broker-dealers and investment advisers.[40] The Request

market participants had difficulty determining whether a financial professional was an investment adviser or a broker-dealer and instead believed that investment advisers and broker-dealers offered the same services and were subject to the same duties. RAND noted, however, that generally investors they surveyed as part of the study were satisfied with their financial professional, be it a representative of a broker-dealer or an investment adviser. Angela A. Hung, et al., *RAND Institute for Civil Justice, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008) (''RAND Study''). *See also* Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, et al., (Sept. 15, 2010) (submitting the results of a national opinion survey regarding U.S. investors and the fiduciary standard conducted by ORC/Infogroup for the Consumer Federation of America, AARP, the North American Securities Administrators Association, the Certified Financial Planner Board of Standards, Inc., the Investment Adviser Association, the Financial Planning Association and the National Association of Personal Financial Advisors (''CFA 2010 Survey'')).

[29] CFA 2017 Letter.

[30] *See, e.g.,* Letter from Kirt A. Walker, President and Chief Operating Officer, Nationwide Financial (Nov. 2, 2017) ((''Nationwide Letter''); Letter from Deneen L. Donnley, Executive Vice President, Chief Legal Officer Corp, USAA (Aug. 31, 2017) (''USAA Letter''); Letter from Dorothy M. Donohue, Acting General Counsel, Investment Company Institute (Aug. 7, 2017) (''ICI August 2017 Letter'').

[31] *See, e.g.,* Letter from Barbara Roper, Director of Investor Protection, CFA to the Department of Labor (Oct. 3, 2017) (acknowledging that some customers are better off in commission accounts); *see also* Tully Report; 913 Study at 151–54 (discussing potential costs to retail investors, including loss of choice, if the broker-dealer exclusion from the Advisers Act were eliminated).

[32] *See id. See also* Nationwide Letter; Letter from James D. Gallagher, Executive Vice President and General Counsel, John Hancock Life Insurance Company (U.S.A.) (Aug. 25, 2017) (''John Hancock Letter''); Letter from Craig S. Tyle, Executive Vice President and General Counsel, Franklin Templeton Investments (''Franklin Templeton Letter'') (Aug. 7, 2017); ICI August 2017 Letter; USAA Letter.

[33] Conflicts of interest are not unique to the broker-dealer commission-based relationship. A firm may earn more revenue in a fee-based account rather than a commission-based account, and may therefore have an incentive to recommend such a fee-based account even if a commission-based advice relationship would be appropriate and less costly for the customer. Customers with low trading activity or long-term buy-and-hold investors in particular may pay less in a commission-based account. An asset-based fee for advice also creates a conflict because the firm is paid regardless of whether it services the account, creating a disincentive to act. In addition, a firm may have an incentive to recommend that a customer maintain assets in either a fee-based account or a commission-based account, even though it would be more appropriate for the customer to use assets in the account to, for example, pay off an outstanding loan, because the firm could continue to earn either kind of fee while the assets remain in the account.

[34] *See* Release 51523; *see also* Request, *infra* note 40.

[35] Release 51523 at 3, 35.

[36] *See* 913 Study, *supra* note 1.

[37] *Id.*

[38] *Id.*

[39] *See* 913 Study at viii, x, 101, 109, 166.

[40] *See Request for Data and Other Information: Duties of Brokers, Dealers and Investment Advisers,* Continued

sought information on the benefits and costs of the current standards of conduct for broker-dealers and investment advisers, as well as alternative approaches to the standards of conduct, including a uniform fiduciary standard.

The Commission received more than 250 comment letters from industry groups, individual market participants, and other interested persons in response to the Request.[41] The vast majority of commenters provided qualitative responses to the specific assumptions contained in the Request, while a few industry commenters submitted surveys and other quantitative data. Most commenters expressed support for a uniform fiduciary standard of conduct requiring firms to ''act in the best interest'' of the investor although they had different views of what the standard would require and expressed concerns about its implementation.[42]

In November 2013, the Commission's Investor Advisory Committee (''IAC'') adopted a recommendation on implementing a uniform fiduciary standard (as proposed by the Investor as Purchaser Subcommittee).[43] In the IAC's view, the current regulatory regime for broker-dealers does not offer adequate investor protection when broker-dealers are providing advice, as under the suitability standard, broker-dealers generally remain free to place their own interests ahead of the interest of their customers.[44] The IAC also expressed its view that any economic analysis should acknowledge the existence and importance of investor harm that can result from the current suitability standard.[45] In considering the optimal regulatory approach to take with respect to imposing a fiduciary duty on broker-dealers, the overarching recommendation from the IAC was that ''the Commission should weigh its various options with an eye toward determining which will best ensure an outcome that strengthens investor protections, preserves investor choice with regard to business models and compensation methods, and is workable for broker-dealers and investment advisers alike.'' [46] The IAC recommended to the Commission two options for imposing a fiduciary duty on broker-dealers when they are providing personalized advice to retail investors: (1) Narrow the broker-dealer exclusion from the definition of ''investment adviser'' under the Investment Advisers Act of 1940 (''Advisers Act'') (the IAC's preferred approach); or (2) engage in rulemaking under Section 913 to adopt a principles-based fiduciary duty that is ''no weaker'' than the standard under the Advisers Act; permit certain sales-related conflicts as long as conflicts are fully disclosed and appropriately managed; and consider whether certain sales practices, conflicts of interest, or compensation schemes should be prohibited or restricted.[47]

2. DOL Rulemaking

The Department of Labor (''DOL'') has also engaged in rulemaking to broaden the definition of ''fiduciary'' in connection with providing investment advice under the Employee Retirement Income Security Act of 1974 (''ERISA'') and the Internal Revenue Code of 1986 (''Code'').[48] Commission staff provided DOL staff with technical assistance and expertise on our regulatory regime as DOL developed its rulemaking.[49]

On April 8, 2016, DOL adopted a new, expanded definition of ''fiduciary'' that treats persons who provide investment advice or recommendations for a fee or other compensation with respect to assets of an ERISA plan or IRA as fiduciaries in a wider array of advice relationships than under the previous regulation (''DOL Fiduciary Rule'').[50] On March 15, 2018, the DOL Fiduciary Rule was vacated by the United States Court of Appeals for the Fifth Circuit.[51]

We understand that the DOL Fiduciary Rule would broadly expand the circumstances in which broker-dealers making recommendations to ERISA plans and ERISA plan participants may be fiduciaries under ERISA, and thus subject to ERISA's prohibited transaction provisions. Similarly, it would expand the circumstances in which broker-dealers providing recommendations to IRAs would be subject to the prohibited transaction provisions of the Code.[52] Among other things, these prohibited transactions provisions generally would prohibit such a fiduciary from engaging in self-dealing and receiving compensation from third parties in connection with transactions involving a plan or IRA, and from acting on conflicts of interest, including using their authority to affect or increase their own compensation, in connection with transactions involving a plan or IRA, or from purchasing or selling any property to ERISA plans or IRAs.[53] As a result, we understand that—in the absence of an exemption from the DOL—broker-dealers that would be considered to be a ''fiduciary'' under the DOL Fiduciary Rule would not only be prohibited from engaging in purchases and sales of certain investments for their own account (*i.e.,* engaging in principal transactions), but more significantly, would be prohibited from receiving

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Exchange Act Release No. 69013 (Mar. 1, 2013), *available at http://www.sec.gov/rules/other/2013/34-69013.pdf*; *see also SEC Seeks Information to Assess Standards of Conduct and Other Obligations of Broker-Dealers and Investment Advisers* (press release), *available at http://www.sec.gov/news/press/2013/2013-32.htm.*

[41] Comments submitted in response to the Request are *available at https://www.sec.gov/comments/4-606/4-606.shtml.*

[42] For example, some commenters supported a new uniform, rules-based fiduciary standard of conduct that is tailored to broker-dealers' business models, but also expressed concern about, among other things, the costs of implementation, the need to preserve investor choice and avoid regulatory duplication or conflict. *See, e.g.,* Letter from Ira D. Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association (''SIFMA'') (July 5, 2013). Others tended to support a uniform fiduciary standard of conduct that is ''no less stringent'' than the current standard under the Advisers Act (*i.e.,* extending the current standard of conduct to broker-dealers), but were concerned about ''watering down'' the current Advisers Act standard to accommodate broker-dealers' business models. *See, e.g.,* Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America (July 5, 2013); Letter from David G. Tittsworth, Executive Director, Investment Adviser Association (July 3, 2013).

[43] Recommendation of the Investor Advisory Committee: Broker-Dealer Fiduciary Duty (Nov. 2013) (''IAC Recommendation''), *available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation-2013.pdf.* The IAC also recommended that the Commission engage in rulemaking to adopt a uniform, plain English disclosure document that includes certain basic information (*e.g.,* fees and conflicts of interest). *Id.* We are considering this recommendation separately as part of the Relationship Summary Proposal.

[44] *Id.*

[45] *Id.*

[46] *Id.*

[47] *Id.*

[48] *See* Definition of the Term ''Fiduciary'' Conflict of Interest Rule—Retirement Investment Advice, 81 FR 20945, 20958–59 (Apr. 8, 2016) (to be codified at 29 CFR pts. 2509, 2510, 2550) (''DOL Fiduciary Rule Release''). The DOL has authority to issue regulations under ERISA and prohibited transaction provisions under the Code, including authority to define the circumstances in which persons, including broker-dealers and investment advisers, are ''fiduciaries'' for purposes of ERISA and the Code as a result of providing ''investment advice'' to plans and IRAs.

[49] *See id.*

[50] 29 CFR 2510.3–21 (effective June 9, 2017). This rule also applies to the definition of fiduciary in the prohibited transaction provisions under the Code. *See* 29 CFR 2510.3–21(F). *See also* DOL Fiduciary Rule Release.

[51] *Chamber of Commerce of the U.S.A., et al.* v. *U.S. Dep't of Labor, et. al.,* No. 17–10238 (5th Cir.) (Mar. 15, 2018).

[52] *See* Best Interest Contract Exemption, 81 FR 21002, 21089 (Apr. 8, 2016) (''BIC Exemption Release''), as corrected Best Interest Contract Exemption; Correction (Prohibited Transaction Exemption 2016–01), 81 FR 44773 (July 11, 2016) (''BIC Exemption''). DOL stated in the BIC Exemption Release that it ''anticipates that the [DOL Fiduciary Rule] will cover many investment professionals who did not previously consider themselves to be fiduciaries under ERISA or the Code.''

[53] *See* BIC Exemption Release at 21002.

common forms of broker-dealer compensation (notably, transaction-based compensation), which would effectively eliminate a broker-dealer's ability or willingness to provide investment advice with respect to investors' retirement assets.[54]

To avoid this result, in connection with the DOL Fiduciary Rule, DOL published two new administrative class exemptions from the prohibited transaction provisions of ERISA and the Code—the Best Interest Contract Exemption (''BIC Exemption'') and the Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (''Principal Transactions Exemption'')—as well as amendments to previously granted prohibited transaction exemptions (collectively referred to as ''PTEs'').[55] The BIC Exemption and the Principal Transactions Exemption would allow persons who are deemed investment advice fiduciaries under the DOL Fiduciary Rule, such as broker-dealers, to receive various forms of compensation (*e.g.,* brokerage commissions) and to engage in certain principal transactions, respectively, that in the absence of an exemption, would be prohibited under ERISA and the Code.[56]

Specifically, the BIC Exemption would provide conditional relief for an ''adviser,'' as that term is used in the context of the BIC Exemption,[57] and the adviser's firm, to receive common forms of ''conflicted'' compensation, such as commissions and third-party payments (such as revenue sharing), provided that the adviser's firm meets certain conditions.[58] Generally, the BIC Exemption would require that the advice must be provided pursuant to a written contract executed between the adviser's firm and the investor (and enforceable against the adviser's firm).[59] The contract must include specific language and disclosures, including (among others) provisions: Acknowledging fiduciary status; committing the firm and the adviser to adhere to standards of impartial conduct (*i.e.,* providing advice in the investor's best interest; charging only reasonable compensation; and avoiding misleading statements about fees and conflicts of interest) (''Impartial Conduct Standards''); and warranting the adoption of policies and procedures reasonably designed to ensure that advisers provide best interest advice and minimize the harmful impact of conflicts of interest. The firm must also disclose information on the firm's and advisers' conflicts of interest and the cost of their advice and provide certain ongoing web disclosures.[60] As noted above, we understand that, as a practical matter, most broker-dealers offering IRA brokerage accounts would need to meet the conditions of the BIC Exemption to advise (*i.e.,* make recommendations to) brokerage customers with IRA accounts and to receive transaction-based and other compensation (including amounts paid from third parties, such as 12b–1 fees) in connection with their securities recommendations.

Generally, the Principal Transactions Exemption would (1) permit certain principal transactions involving the *purchase* of limited securities (*i.e.,* certificates of deposits, interests in unit investment trusts, and certain debt securities)[61] by a plan or an IRA owner and (2) more broadly permit principal transactions involving the *sale* of ''securities or other investment property'' by the plan or IRA owner, conditioned on adherence to, among other things, Impartial Conduct Standards,[62] as well as a contract requirement and a policies and procedures warranty that mirror the requirements in the BIC Exemption.[63] The Principal Transactions Exemption also includes some conditions that are different from those in the BIC Exemption, including credit and liquidity standards for debt securities sold to plans and IRAs pursuant to the exemption and additional disclosure requirements.[64]

The revised definition of ''fiduciary,'' as well as the Impartial Conduct Standards, became effective on June 9, 2017.[65] Compliance with the remaining

[54] *See generally* BIC Exemption; Principal Transactions Exemption, *infra* note 55.

[55] *See, e.g.,* BIC Exemption Release (permitting certain ''Financial Institutions'' and ''Advisers'' to receive compensation resulting from a provision of investment advice in connection with securities transactions, including riskless principal transactions); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Prohibited Transaction Exemption 2016–02), 81 FR 21089, 21105–10 (Apr. 8, 2016) (''Principal Transactions Release''); corrected at Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, 81 FR 44784 (July 11, 2016) (''Principal Transactions Exemption'') (permitting investment advice fiduciaries to sell or purchase certain debt securities and other investments in principal transactions and riskless principal transactions). *See also* Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 86–128 for Transactions Involving Employee Benefit Plans and Broker-Dealers; Amendment to and Partial Revocation of PTE 75–1, Exemptions from Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 81 FR 21181 (Apr. 8, 2016) (permitting broker-dealers exercising investment discretion to receive commissions and other fees for effecting securities transactions as agent for a plan or IRA, under certain conditions, including Impartial Conduct Standards like those applicable under the BIC Exemption); DOL Fiduciary Rule Release, *supra* note 48, 81 FR at 20991 (describing the new BIC Exemption, Principal Transactions Exemption, and amendments to existing PTEs).

[56] *See generally* BIC Exemption; Principal Transactions Exemption.

[57] The DOL explains that by using the term ''adviser,'' it ''does not intend to limit the exemption to investment advisers registered under the Investment Advisers Act of 1940 or under state law,'' and that rather, for purposes of the BIC Exemption, an adviser ''is an individual who can be a representative of a registered investment adviser, a bank or similar financial institution, an insurance company, or a broker-dealer.'' BIC Exemption Release, *supra* note 52, 81 FR at 21003, n.2.

[58] *See* BIC Exemption Release. ERISA and the Code generally prohibit fiduciaries from receiving payments from third parties and from acting on conflicts of interest, including using their authority to affect or increase their own compensation, in connection with transactions involving a plan or IRA. Certain types of fees and compensation common in the retail market, such as brokerage or insurance commissions, rule 12b–1 fees and revenue sharing payments, may fall within these prohibitions when received by fiduciaries as a result of transactions involving advice to the plan, plan participants and beneficiaries, and IRA owners. *Id.*

[59] *See* BIC Exemption Release.

[60] *See* BIC Exemption.

[61] Debt securities are generally registered corporate debt securities, treasury securities, agency securities, and asset-backed securities that are guaranteed by an agency or government sponsored enterprise. *See* Principal Transactions Exemption.

[62] In the Principal Transactions Exemption, the Impartial Conduct Standards specifically refer to the fiduciary's obligation to seek to obtain the best execution reasonably available under the circumstances with respect to the transaction, rather than to receive no more than ''reasonable compensation.'' *See* Principal Transactions Exemption. The Principal Transactions Exemption provides that the adviser may satisfy the obligation under the exemption to obtain best execution reasonably available under the circumstances with respect to the transaction by complying with FINRA rules on fair pricing and best execution (Rules 2121—Fair Prices and Commissions; 5310—Best Execution and Interpositioning). *See* Principal Transactions Exemption, Section II(c)(2)(i).

[63] *See* Principal Transactions Exemption; 18-Month Extension of Transition Period and Delay of Applicability Dates; Best Interest Contract Exemption (PTE 2016–01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (PTE 2016–02); Prohibited Transaction Exemption 84–24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters (PTE 84–24), 82 FR 56545 (Nov. 29, 2017) (''DOL November Extension''), *available at https://federalregister.gov/d/2017-25760.*

[64] *See* Principal Transactions Exemption; DOL November Extension.

[65] *See* Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice; Best Interest Contract Exemption (Prohibited Transaction Exemption 2016–01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Prohibited

Continued

conditions of the BIC Exemption and the Principal Transaction Exemption, such as the general contract requirement, and conditions requiring specific written warranties and disclosures, has been delayed until July 1, 2019.[66] During this transition period, ''financial institutions'' and ''advisers,'' as defined in the PTEs, are currently only required to comply with the Impartial Conduct Standards to satisfy the conditions of these PTEs.[67]

3. Statement by Chairman Clayton

In light of the DOL Fiduciary Rule and related PTEs, and in recognition of the significant developments in the marketplace that have occurred since the Commission last solicited information from the public in 2013, Chairman Clayton issued a statement on June 1, 2017 containing a number of questions regarding standards of conduct for investment advisers and broker-dealers.[68] The public input was intended to provide the Commission with an updated assessment of the current regulatory framework, the current state of the market for retail investment advice, and market trends.[69] Chairman Clayton also invited commenters to submit data and other information that may inform the Commission's analysis, including data covering periods since the 2013 solicitation of comment.

To date, over 250 comments have been received from the public in response to the Chairman Clayton Statement. While some commenters opposed any changes to the standard of conduct [70] and offered other options,[71] for the most part, commenters support changes to the standards of conduct for investment advice, and in particular the establishment of a fiduciary or best interest standard specific to broker-dealers [72] or, alternatively, a standard of conduct that uniformly applies to investment advisers and broker-dealers.[73]

In addition to this statement, Chairman Clayton and the staff have continually engaged in other outreach, including meetings with retail investors, investor advocacy groups, and industry participants, to better understand these issues.

Commenters have also expressed their views on the effects of the DOL Fiduciary Rule and the related PTEs—both in terms of benefits and drawbacks—on brokerage advice relationships, at least with respect to retirement advice. Among other things, some commenters asserted that, because of complex and burdensome requirements imposed as part of the BIC Exemption, and the associated litigation risk, broker-dealers are changing the types of products and accounts offered to retirement investors, and focusing on products or accounts with compliance-friendly fee structures, such as level fees or lower-cost products (*e.g.,* eliminating the provision of advice in IRA brokerage accounts and shifting these accounts to asset-based accounts).[74] Commenters expressed concerns that retirement investors will be harmed through reduced product choice, increased cost for retirement advice (if shifted to fee-based arrangements that may be more costly for buy-and-hold investors, or if there are increases in account minimums for commission-based accounts), or lost or restricted access to advice (if investors have small account balances or cannot otherwise afford a fee-based arrangement or the increased cost of a commission-based account).[75]

Transaction Exemption 2016–02); Prohibited Transaction Exemptions 75–1, 77–4, 80–83, 83–1, 84–24 and 86–128 Proposed Rule, 82 FR 16902, (Apr. 7, 2017) (''DOL April Extension''), *available at https://www.gpo.gov/fdsys/pkg/FR-2017-04-07/pdf/2017-06914.pdf. But see Chamber of Commerce of the U.S.A., et. al.* v. *U.S. Dep't of Labor, et. al.,* No. 17–10238 (5th Cir.) Mar. 15, 2018).

[66] *See* DOL November Extension.

[67] *Id.*

[68] Chairman Jay Clayton, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers* (June 1, 2017) (''Chairman Clayton Statement''), *available at https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31.*

[69] *See* Chairman Clayton Statement.

[70] *See, e.g.,* Letter from Dan Pisenti, Whitehall-Parker Securities, Inc. (July 7, 2017) (''Whitehall Letter'') (arguing that the suitability standard is highly effective and no further government intervention is necessary); Letter from Kevin Dunnigan (July 5, 2017) (stating that the DOL Fiduciary Rule is government overreach and consumers should be able to decide what to purchase).

[71] *See, e.g.,* Letter from Herb W. Morgan (June 2, 2017) (stating that a more effective solution would be a simpler one, including increasing penalties and enforcement and requiring full fee disclosure); Letter from Mark D. Moss (June 2, 2017) (supporting SEC involvement in standardizing nomenclature).

[72] *See, e.g.,* CFA 2017 Letter (supporting the Commission taking a ''more rigorous approach'' to interpreting the fiduciary standard by developing a new standard for brokers under the [Securities Exchange Act of 1934] and in enforcing the existing standard under the Advisers Act and stating that the fiduciary duty must include a principles-based, legally enforceable best interest standard); Letter from Gail C. Bernstein, General Counsel, Investment Advisers Association (Aug. 31, 2017) (''IAA Letter'') (recommending the SEC develop a best interest standard for brokers that is as robust as the fiduciary standard under the Advisers Act); ICI August 2017 Letter (supporting the SEC taking the lead in establishing and enforcing a best interest standard of conduct for broker-dealers providing recommendations to retail investors); Letter from Kevin Carroll, Managing Director and Associate General Counsel, SIFMA (July 21, 2017) (''SIFMA Letter'') (suggesting the SEC consider a best interest standard for broker-dealers that encompasses the duty of loyalty, duty of care and enhanced up-front disclosures); Letter from Timothy E. Keehan, Vice President, Senior Counsel, American Bankers Association (Sept. 1, 2017) (''ABA Letter''); Letter from David Kowach, Head of Wells Fargo Advisors, Wells Fargo & Company (Sept. 20, 2017) (''Wells Fargo Letter'') (''[We] recommend the SEC establish and enforce a best interest standard of conduct for broker-dealers when they provide personalized investment advice to retail investors that is aligned with the standard of conduct applicable to registered investment advisors.''); Letter from Marc R. Bryant, Senior Vice President and Deputy General Counsel, Fidelity Investments (Aug. 11, 2017) (''Fidelity Letter'') (''Fidelity believes that the SEC should review and consider an enhanced best interest standard of conduct for broker-dealers that is clearly defined, disclosure and materiality-based, and that applies across all of an investor's brokerage accounts and interactions''); Letter from F. William McNabb, Chairman and Chief Executive Officer, The Vanguard Group, Inc. (Sept. 29, 2017) (''Vanguard Letter''); Letter from Derek B. Dorn, Managing Director, Regulatory Engagement and Policy, TIAA (Sept. 26, 2017) (''TIAA Letter'') (supporting application of a best interest standard of conduct to all personalized investment advice provided to retail investors through raising the broker-dealer standard and maintaining the investment adviser standard); Letter from Robert Grohowski, Vice President, Senior Legal Counsel—Legislative and Regulatory Affairs, T. Rowe Price (Oct. 12, 2017) (''T. Rowe Letter'') (''Given the history, we believe that the SEC's best path forward would be to focus specifically on updating the standard applicable to non-discretionary broker-dealer recommendations, irrespective of account type.''); Letter from Americans for Financial Reform (Sept. 22, 2017) (''AFR Letter'') (proposing extension of a strong fiduciary ''best interest'' standard to all those who hold themselves out as advisers or offer personalized investment advice to clients and focusing on broker-dealer business model).

[73] *See, e.g.,* Letter from David Certner, Legislative Counsel & Legislative Policy Director, Government Affairs, AARP (Sept. 6, 2017) (''AARP Letter'') (''Adoption of a uniform standard that would apply to both broker-dealers and investment advisers when providing personalized investment advice to retail customers, as contemplated by Section 913. . . . is of critical importance and long overdue.''); PIABA Letter (''The lack of a uniform standard of conduct creates a discrepancy between the law and investors' reasonable expectations.''); Letter from Barbara Novick, Vice Chairman, and Nicole Rosser, Vice President, BlackRock, Inc. (Aug. 7, 2017) (''BlackRock Letter'') (supporting a best interest standard that applies to all types of retail accounts); Letter from Ronald J. Kruszewski, Chairman & CEO, Stifel, Nicolaus & Co. (July 25, 2017) (''Stifel Letter'') (supporting a single standard of care applicable to both brokerage and advisory accounts, while recognizing the inherent differences between these relationships); Letter from Christopher Jones, Executive Vice President of Investment Management and Chief Investment Officer, Financial Engines (Oct. 11, 2017) (''Financial Engines Letter'') (recommending harmonization of the standards applicable to broker-dealers and investment advisers to advance ''high-quality, unconflicted advice''); Letter from Gretchen Cepek, Senior Vice President and General Counsel and Stewart D. Gregg, Senior Counsel, Allianz Life Insurance Company of North America (Oct. 13, 2017) (''Allianz Letter'') (supporting a uniform ''best interest'' standard of conduct applicable to both broker-dealers and investment advises providing services to retail investors).

[74] *See, e.g.,* BlackRock Letter; ICI August 2017 Letter.

[75] *See, e.g.,* Letter from Kevin Carroll, Managing Director and Associate General Counsel, SIFMA (July 21, 2017) (''SIFMA 2017 Letter'') (stating that

Other commenters have noted, however, that such outcomes are not mandated by the DOL Fiduciary Rule, any market disruptions will be addressed by the market, and overall, the adjustment to the DOL Fiduciary Rule has been positive for retirement investors, as the rule has resulted in lower fees, advice in the best interest, and minimized conflicts in advice provided to individuals,[76] including, for example, the development of new product offerings such as ''clean shares'' that do not have any sales loads, charges or other asset-based fee for sales or distribution.[77]

B. General Objectives of Proposed Approach

In developing this proposal, we considered the variety of products and services, including the types of advice, that broker-dealers provide to investors; the characteristics of investors who utilize brokerage services; the associated cost and relative affordability of such services; the embedded compensation conflicts associated with these products and services; and the potential impact of such conflicts on investor outcomes (such as evidence suggestive that the failure to apply a ''best interest'' obligation to conflicted advice has resulted in investor harm).[78] We also considered the regulatory landscape applicable to broker-dealers under the Exchange Act and SRO rules and the investor protections provided when broker-dealers recommend securities transactions or investment strategies to retail customers, and any differences between those protections provided for broker-dealer services under other regulatory regimes, particularly those that would exist under the DOL Fiduciary Rule and the BIC Exemption.

We also considered retail customer confusion about the obligations broker-dealers owe when making recommendations and how that confusion may ultimately translate into or exacerbate the potential for investor harm (such as through a misalignment of investor expectations regarding the level of protection received and the level of protection actually provided).[79] We also recognized the importance of providing, to the extent possible, clear, understandable, and consistent standards for brokerage recommendations across a brokerage relationship (*i.e.,* for both retirement and non-retirement purposes) and better aligning this standard with other advice relationships (*e.g.,* a relationship with an investment adviser).[80] We also sought to preserve—to the extent possible—investor choice and access to existing products, services, service providers, and payment options. We sought to avoid a lack of clarity or consistency in the applicable standards and a lack of coordination among regulators, which could ultimately undermine investor choice and access and create legal uncertainty in developing effective compliance programs.

At the same time, we are sensitive to the potential risk that any additional regulatory burdens may cause investors to lose choice and access to products, services, service providers, and payment options.[81] In particular, we sought to preserve the ability of investors to pay for advice in the form of brokerage commissions. Various commenters asserted that the commission-based model may be more appropriate for many investors,[82] and we believe that such investors may prefer a commission-based brokerage

the impact of the new DOL Fiduciary Rule has been to significantly shift IRAs from brokerage accounts to advisory accounts, from personal service to call centers or the internet, and to limit the products and fee arrangements available to IRAs); BlackRock Letter (stating that some financial services firms have indicated that they would not offer or would limit IRA brokerage platforms because of the compliance complexities of the BIC Exemption provisions that would go into effect on January 1, 2018 [now delayed until July, 2019], as well as the risk of class action); ICI August 2017 Letter (stating that the DOL Fiduciary Rule and related exemptions is ''limiting retirement savers' choices, restricting their access to information they need for retirement planning, and increasing costs, particularly for those savers who can least afford it''); Letter from Dave Paulsen, Executive Vice President and Chief Distribution Officer, Transamerica (Nov. 20, 2017) (''[A]s a result of the DOL Rule, many broker-dealers are no longer selling variable annuities in an IRA, but continue to sell variable annuities to retail investors.'').

[76] *See, e.g.,* AARP Letter.

[77] *See id. See also* Letter from AFL–CIO, AFSCME, Alliance for Retired Americans, et al. (Aug. 21, 2017) (''AFL–CIO Letter''); Letter from Aron Szapiro, Director of Policy Research, Morningstar, Inc. (Sept. 11, 2017) (''Morningstar Letter'').

[78] *See, e.g.,* Economic Policy Institute Letter; CFA 2017 Letter; IAC Recommendation.

[79] *Id.*

[80] *See, e.g.,* Letter from Richard Foster, Senior Vice President and Senior Counsel for Regulatory and Legal Affairs, Financial Services Roundtable (Oct. 17, 2017) (''FSR Letter'') (''FSR strongly believes a single standard for broker-dealers servicing both retirement and non-retirement assets is in the best interest of retail customers, because it would reduce customer confusion and ultimately provide customers a higher-level of service. A single standard also would avoid the cost of developing and implementing compliance and supervisory programs around different standards of conduct.''); Morningstar Letter (''Morningstar believes that investors' confusion about standards of conduct applicable to different kinds of relationships is likely to continue for some time, and disclosures alone will not clarify those standards for many investors. . . . Further, even among experienced investors who hold investments outside of retirement accounts, most investors do not understand the distinctions between broker-dealers and Registered Investment Advisors and the conflicts of interest some financial advisors may have when recommending investments''); TIAA Letter (''Investors should understand the standards of conduct that apply to the financial advisers who give them advice—but today's disparate standards can easily lead to investor confusion.''); IAA Letter (''An equally stringent standard is also necessary to reduce confusion for investors and ensure that they do not bear the burden of having uncertainty about the standard of conduct that applies to the investment professional they choose.''); PIABA Letter.

[81] *See, e.g.,* SIFMA 2017 Letter; BlackRock Letter; ICI August 2017 Letter; Franklin Templeton Letter (''[W]hile asset-based fees are appropriate in many circumstances, for some investors—such as long-term, 'buy-and-hold' investors—a transaction-based charge can result in substantial savings. According to the Investment Company Institute, investors who plan to hold fund shares for longer than five years would end up with a higher account balance under a commission-based approach that charges a 2.5 percent front-end fee (plus an ongoing 12b–1 fee) than investors paying a 1 percent per year asset-based fee.'')

[82] *See, e.g.,* USAA Letter (''USAA has deep reservations about any standard of conduct that serves to advantage fee-based accounts and serves to disadvantage other types of accounts and product choices. Put simply, a fee-based model may not always be appropriate for lower-balanced accounts. In many cases, these accounts will be better served by straight-forward investments in mutual funds or exchange-traded funds, without such accounts being assessed an ongoing management fee.''); Letter from Stephen McManus, Senior Vice President and General Counsel, State Farm Mutual Automobile Insurance Company (Aug. 21, 2017) (''State Farm Letter'') (''Long a mainstay of the financial services industry, sales commissions are frequently preferred by middle-income consumers whose 'buy-and-hold' strategy does not require the continuous investment advice that is more suited to a percentage fee based on assets under management. This preference also reflects the fact that the payment of commission-based compensation—tied as it is to a particular transaction—is easy for consumers to understand and, in *e.g.,* many cases, represents good value for smaller or low-volume accounts.''). *See* Letter from Sharon Cheever, Senior Vice President and General Counsel, Pacific Life Insurance Company (Oct. 16, 2017) (''Pacific Life Letter'') (''There is a common misconception that a fee-based compensation model is somehow better for the consumer, in part, because it is allegedly cheaper and less likely to lead to conflicts of interest. This unfair discrimination against the commission-based compensation model is truly unfounded. The expense to the client in terms of actual money paid on an on-going basis, and thus, 'fee-drag' on their investment return, will often be more with the fee-based compensation model. For example, annuities by nature are long-term investments, and with the fee-based compensation model, the adviser charges a certain percentage (1%) or dollar amount each year for the management of the investment. Compare this to the commission-based compensation model, where there is typically a larger percentage charged upfront (*e.g.,* 5–6%), and you can see that the longer term the investment, the more expensive a fee-based compensation model can be for the client.''); Carl B. Wilkerson, Vice President and Chief Counsel, Securities & Litigation, American Council of Life Insurers (Oct. 3, 2017) (''ACLI Letter'') (''Recurrent annual fees may be ill-suited to individuals with moderate assets needing little annual advice, and may exceed the total value of a commissioned-based adviser.''). *See also* FINRA Notice to Members 03–68, Fee-Based Compensation (Nov. 2003).

relationship over a fee-based account.[83] We also share concerns raised by commenters about retail customers losing access to advice they receive through recommendations from broker-dealers, or if advice from broker-dealers is effectively eliminated, particularly as not all such customers have the option to move to fee-based accounts.[84]

After extensive consideration of these issues, we are proposing to enhance existing broker-dealer conduct obligations when they make recommendations to a retail customer. For such recommendations, the proposed rule would require a broker-dealer ''to act in the best interest of the retail customer . . . without placing the financial or other interest of the [broker-dealer] making the recommendation ahead of the interest of the retail customer.''

The proposed best interest obligation for broker-dealers set forth in Regulation Best Interest builds upon, and is tailored to, existing broker-dealer relationships and regulatory obligations under the federal securities laws and SRO rules. In particular, the existing rules of various SROs served as an important point of reference for our proposal. However, we tailored and enhanced these requirements to the specific proposed best interest obligation we are seeking to establish. Our proposal also takes into consideration and draws on (to the extent appropriate) the principles of the obligations that apply to investment advice in other contexts, including those described above. We preliminarily believe it makes more sense to build upon this regulatory regime, rather than to create a completely new standard or simply adopt obligations and duties that have developed under a separate regulatory regime to address a different type of advice relationship.

We believe this approach would have several benefits. First, it would enhance the quality of recommendations provided by broker-dealers to retail customers. Second, it would enhance disclosure, helping retail customers evaluate recommendations received from broker-dealers, and reducing confusion regarding the nature of the broker-dealer relationship. Third, it would facilitate more consistent regulation of similar activity, drawing from key principles underlying the fiduciary obligations that apply to investment advice in other contexts. Fourth, it would better align the legal obligations of broker-dealers with investors' expectations.

We also believe that the best interest obligation we are proposing today would help preserve investor choice and access to affordable investment advice and products that investors currently use. As discussed below, Regulation Best Interest would only apply when a broker-dealer is making a recommendation to a retail customer about a securities transaction or an investment strategy involving securities. The regulation would not apply to the provision of services that do not involve or are distinct from such a recommendation, including, but not limited to, executing an unsolicited transaction for a retail customer, or to a broker-dealer that is dually-registered as an investment adviser (a ''dual-registrant'') when making a recommendation in its investment adviser capacity.[85] In this way, our proposed best interest obligation should enhance investor protection while generally preserving (to the extent possible) the range of choice and access—both in terms of services and products—that is available to brokerage customers today.

We recognize that as a result of the enhanced obligations that would apply, some broker-dealers may determine that it is not cost-effective to continue to recommend certain products or services to retail customers (because, for example, of the difficulty in mitigating certain compensation related conflicts). Others may pass along the costs to retail customers. Some retail customers may seek out a different advice relationship that better suits their preferences after receiving the required disclosures. As discussed in more detail in Section IV, we preliminarily believe that any such impacts that the proposed regulatory changes may have on retail customer access to and availability of investment advice, and the costs to broker-dealers, would be justified by the benefits of the enhancements to investor protection. We also believe that for both retail customers and broker-dealers the potential costs would be less—and the benefits would be greater—than under the potential regulatory alternatives we considered.[86]

In proposing Regulation Best Interest, we are not proposing to amend or eliminate existing broker-dealer obligations, and compliance with Regulation Best Interest would not alter a broker-dealer's obligations under the general antifraud provisions of the federal securities laws. Regulation Best Interest applies in addition to any obligations under the Exchange Act, along with any rules the Commission may adopt thereunder, and any other applicable provisions of the federal securities laws and related rules and regulations.[87] Furthermore, we do not believe proposed Regulation Best Interest would create any new private right of action or right of rescission, nor do we intend such a result.[88]

Scienter would not be required to establish a violation of Regulation Best Interest. One key difference and enhancement resulting from the obligations imposed by Regulation Best Interest as compared to a broker-dealer's existing suitability obligations under the antifraud provisions of the federal securities laws, is that a broker-dealer would not be able to satisfy its Care Obligation discussed in Section D.2 through disclosure alone.

Similarly, the existing rules of various SROs served as an important point of reference for our proposal. However, we tailored and enhanced these existing

[83] *See* Foy, Michael, ''What's at stake for forward-thinking firms,'' Fiduciary Roulette, J.D. Power, *available at http://www.jdpower.com/resource/wealth-management-fiduciary-roulette* (visited January 31, 2018) (finding that 59% of investors who currently pay commissions '''probably would not' or 'definitely would not' stay with their current firm if required to switch to a fee-based arrangement''). Irrespective of any real or perceived investor preference, the last 12 years have seen a decline in the number of broker-dealers from over 6,000 in 2005 to less than 4,000 in 2016, alongside a simultaneous increase in the number of Commission-registered investment advisers from approximately 9,000 in 2005 to over 12,000 in 2016. The Commission understands that firms have transitioned to fee-based retail business in an effort to, among other things, provide stability, increase profitability, lower perceived regulatory burden, provide more or better services to retail investors, and reduce or eliminate conflicts of interest. *See* discussion Section IV.C.1.c, *infra.*

[84] *See supra* note 74; *see also* USAA Letter (''It is critical that a uniform standard does not impose excessive legal and compliance burdens on such firms, which would effectively incent firms to curtail or even close services to these investors. A standard that effectively bans or incents firms to abandon certain business models will harm retail investors, especially our men and women in uniform, by raising their costs, reducing their choices, and restricting their access to needed investment advice.''); Franklin Templeton Letter (''At the same time, broker-dealers should not be subject to overly prescriptive requirements or to enforcement through private litigation from the professional plaintiff's bar. This will only lead to additional costs and a decrease in the availability of investment choices and advice to those retail investors who need it most.'').

[85] *See infra* Section II.C.4. for further discussion.

[86] *See* Section IV.

[87] For example, any transaction or series of transactions, whether or not subject to the provisions of Regulation Best Interest, remain subject to the antifraud and anti-manipulation provisions of the securities laws, including, without limitation, Section 17(a) of the Securities Act of 1933 (''Securities Act'') [15 U.S.C. 77q(a)] and Sections 9, 10(b), and 15(c) of the Exchange Act [15 U.S.C. 78i, 78j(b), and 78o(c)] and the rules thereunder.

[88] Regulation Best Interest is being proposed, in part, pursuant to the authority provided by Section 913(f) of the Dodd-Frank Act and Section 15(l) of the Exchange Act. Neither Section 913(f) nor Section 15(l), by its terms, creates a new private right of action or right of rescission.

SRO requirements to the specific proposed best interest obligation we were seeking to establish. As a result, we recognize that there may be overlapping regulatory requirements applicable to the same activity. We are mindful of potential regulatory conflicts or redundancies and have sought in proposing Regulation Best Interest to avoid such conflicts and minimize redundancies, but consistent with our goal of establishing a best interest obligation for broker-dealers. Overall, we believe that proposed Regulation Best Interest is generally designed to be consistent with and build upon the relevant SRO requirements.[89]

We wish to underscore that proposed Regulation Best Interest focuses on specific enhancements to the broker-dealer regulatory regime, in light of the unique characteristics of the brokerage advice relationship and associated services that may be provided, and therefore would be separate and distinct from the fiduciary duty that has developed under the Advisers Act. Further, we do not intend that Regulation Best Interest, including the associated obligations, have any impact on the Commission's or its staff's interpretations of the scope or nature of an investment adviser's fiduciary obligations.[90]

II. Discussion of Regulation Best Interest

A. Overview of Regulation Best Interest

The Commission is proposing a new rule, referred to as Regulation Best Interest, to establish an express best interest obligation that would apply to broker-dealers when making a recommendation of any securities transaction or investment strategy to a retail customer. The proposed best interest obligation, which is set forth in proposed paragraph (a)(1), would require a broker-dealer, when making a recommendation, ''to 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 a natural person who is an associated person of a broker or dealer making the recommendation ahead of the interest of the retail customer.'' Regulation Best Interest would specifically provide that this best interest obligation shall be satisfied if:

- 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, reasonably discloses to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer and all material conflicts of interest that are associated with the recommendation (the ''Disclosure 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, skill, and prudence to: (1) Understand the potential risks and rewards 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; (2) have a reasonable basis to believe that the recommendation is in the best interest of a particular retail customer based on the retail customer's investment profile and the potential risks and rewards associated with the recommendation; and (3) 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 (herein, ''Care Obligation'');
- The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with recommendations; and
- The broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations (the last two together, the ''Conflict of Interest Obligations'').

We preliminarily believe that establishing an express best interest obligation and defining it in this manner would enhance the quality of recommendations provided, and would align broker-dealers' obligations more closely with retail customers' reasonable expectations.[91] The best interest obligation, including the specific component obligations, that we are proposing today would address certain conflicted recommendations and set a clear minimum standard for broker-dealer conduct. Specifically, we believe that it would improve investor protection and the regulation of broker-dealer recommendations in four key ways.

First, it fosters retail customer awareness and understanding by requiring disclosure of the material facts relating to the scope and terms of the relationship with the retail customer.

Second, it is designed to enhance provisions under the federal securities laws relating to the quality of broker-dealer recommendations by establishing an express Care Obligation that sets forth minimum professional standards that encompass and go beyond existing suitability obligations under the federal securities laws, and could not be satisfied through disclosure alone.[92]

Third, it enhances the disclosure of material conflicts of interest. This would help educate retail customers about those conflicts, and help them evaluate recommendations received from broker-dealers.

Fourth, it establishes obligations that require mitigation, and not just disclosure, of conflicts of interest arising from financial incentives associated with the recommendation (such as compensation incentives, incentives to recommend proprietary products, and incentives to effect transactions in a principal capacity).

Taken together, we preliminarily believe these enhancements will improve investor protection by minimizing the potential harmful impacts that broker-dealer conflicts of interest may have on recommendations provided to retail customers. Furthermore, it is our understanding that many broker-dealers support the establishment of a best interest standard.[93]

As discussed in more detail below, in developing proposed Regulation Best Interest, the Commission has drawn from principles that apply to investment advice under other regulatory regimes—most notably SRO rules, state common law, the Advisers Act, and any duties that would apply to broker-dealers as a

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[89] Generally, when a requirement of proposed Regulation Best Interest is based on a similar SRO standard, we would expect—at least as an initial matter—to take into account the SRO's interpretation and enforcement of its standard when we interpret and enforce our rule. At the same time, we would not be bound by an SRO's interpretation and enforcement of an SRO rule, and our policy objectives and judgments may diverge from those of a particular SRO. Accordingly, we would also expect to take into account such differences in interpreting and enforcing our rules. We have taken the same approach in other rulemakings that include requirements based on a similar SRO standard. *See, e.g.,* Exchange Act Release No. 77617 (Apr. 14, 2016), 81 FR 29960, 29997 (May 13, 2016) (''Business Conduct Standards Adopting Release'').

[90] *See* Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, Release No. IA–4889, File No. S7–09–18 (''Fiduciary Duty Interpretive Release'').

[91] *See, e.g.,* Letter from David Certner, Legislative Counsel & Legislative Policy Director, Government Affairs, AARP (Sept. 6, 2017) (''AARP'') (''Investors expect financial intermediaries to be required to act in their (the customer's) best interest.'').

[92] *See supra* note 7.

[93] *See, e.g.,* SIFMA 2017 Letter.

result of the DOL Fiduciary Rule and the related PTEs (most notably, the BIC Exemption)—with the goal of both establishing greater consistency in the level of protection provided across registered investment advice relationships (while having the specific regulatory obligations for broker-dealers and investment advisers reflect the structure and characteristics of their relationships with retail customers) and easing compliance with Regulation Best Interest where these other overlapping regulatory regimes are also applicable.

In particular, as a threshold matter, it is worth noting that, in determining how to frame proposed best interest obligation, we considered the ''best interest'' standards outlined in other contexts, in particular the standard set forth in Section 913(g) of the Dodd-Frank Act [94] and the 913 Study recommendation,[95] as well as the DOL's ''best interest'' Impartial Conduct Standard, even though we are not proposing a uniform fiduciary standard under Section 913(g).[96] Our proposed definition differs from the wording of these standards by replacing the phrase ''without regard to the financial or other interest'' with the phrase ''without placing the financial or other interest . . . ahead of the interest of the retail customer.'' We are proposing this change as we are concerned that inclusion of the ''without regard to'' language could be inappropriately construed to require a broker-dealer to eliminate all of its conflicts (*i.e.,* require recommendations that are conflict free), [97] and we believe that our proposed formulation appropriately reflects what we believe is the underlying intent of the ''without regard to . . .'' formulation.

We understand that, like other investment firms, broker-dealers have conflicts of interest, in particular financial interests, when recommending transactions to retail customers. Certain conflicts of interest are inherent in any principal-agent relationship. We do not intend for our standard to prohibit a broker-dealer from having conflicts when making a recommendation. Nor do we believe that is the intent behind the ''without regard to'' phrase, as included in Section 913 of the Dodd-Frank Act or recommended in the 913 Study, as is evident both from other provisions of Section 913 that acknowledge and permit the existence of financial interests under that standard, and how our staff articulated the recommended uniform fiduciary standard.[98] Among other things, Dodd-Frank Act Section 913(g) expressly provides that the receipt of commission-based compensation, or other standard compensation, for the sale of securities shall not, in and of itself, violate any uniform fiduciary standard promulgated under that subsection's authority as applied to a broker-dealer.[99] Moreover, Section 913(g) does not itself require the imposition of the principal trade provisions of Advisers Act Section 206(3) on broker-dealers.[100] In addition, Dodd-Frank Act Section 913 provides that offering only proprietary products by a broker-dealer shall not, in and of itself, violate such a uniform fiduciary standard, but may be subject to disclosure and consent requirements.[101] We believe that these provisions make clear that the overall intent of Section 913 was that a ''without regard to'' standard did not prohibit, mandate or promote particular types of products or business models, and preserved investor choice among such services and products and how to pay for these services and products (*e.g.,* by preserving commission-based accounts, episodic advice, principal trading and the ability to offer only proprietary products to customers).[102]

In lieu of adopting wording that embodies apparent tensions, we are proposing to resolve those tensions through another formulation that appropriately reflects what we believe is the underlying intent of Section 913: That a broker-dealer should not put its interests ahead of the retail customer's interests when making a recommendation to a retail customer. In other words, the broker-dealer's financial interest can and will inevitably exist, but these interests cannot be the predominant motivating factor behind the recommendation. Our proposed language makes this intention clear by stating a broker-dealer and its associated persons are not to put their interests ahead of the retail customer's interests. We request comment below, however, on whether our proposed rule should instead incorporate the ''without regard to'' language set forth in Section 913 and the 913 Study recommendation, which we believe would also generally correspond to the DOL's language in the BIC Exemption, but interpret that phrase in the same manner as the ''without placing the financial or other interest . . . ahead of the interest of the retail customer'' approach set forth above.

We also appreciate the desire for clarity regarding the interpretation of our proposed best interest obligation. In the discussion that follows, we are addressing these concerns by providing clarity about the requirements imposed by the proposed best interest obligation, and offering guidance on how a broker-dealer could comply with these requirements.

Specifically, to provide assistance to broker-dealers complying with the requirements of Regulation Best Interest, the Commission's proposal: (1) Provides guidance setting forth our preliminary views of what the best interest obligation would require, generally; (2) defines the key terms and scope of the proposed best interest obligation; and (3) specifies by rule the specific components with which a broker-dealer

[94] Pursuant to Section 913(g) of the Dodd-Frank Act, ''[t]he Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers . . . shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.'' 15 U.S.C. 80b–11(g)(1); 15 U.S.C. 78o(k)(1). Section 913(g) also provides that ''[s]uch rules shall provide that such standard of conduct shall be no less stringent than the standard applicable to investment advisers under Sections 206(1) and 206(2) [of the Advisers Act].'' *Id.*

[95] *See infra* Section II.D.2.d.2 for a further discussion of how proposed Regulation Best Interest compares to the 913 Study recommendations.

[96] As discussed *supra* note 88, Regulation Best Interest is being proposed, in part, pursuant to the authority provided by Section 913(f) of the Dodd-Frank Act, which provides the Commission discretionary authority to ''commence a rulemaking, as necessary or appropriate to the public interest and for the protection of retail customers (and such other customers as the Commission may by rule provide), to address the legal or regulatory standards of care for brokers, dealers . . . [and] persons associated with brokers or dealers . . . for providing personalized investment advice about securities to such retail customers.'' In doing so, the Commission is required to consider the findings, conclusions and recommendations of the 913 Study.

[97] Some commenters raised similar concerns of potential confusion and uncertainty regarding the expectations associated with including this phrase in the best interest obligation. *See, e.g.,* SIFMA 2017 Letter; T. Rowe Letter; Letter from Jason Chandler, Group Managing Director, Head of Investment Platforms and Solutions Wealth Management Americas, and Micheal Crowl, Group Managing Director, General Counsel, UBS Group Americas and Wealth Management Americas, UBS AG (July 21, 2017) (''UBS Letter'').

Other commenters, however, expressed support for a ''best interest'' obligation that included that the ''without regard to phrase.'' *See, e.g.,* Letter from Christine L. Owens, Executive Director, National Employyment Law Project (Oct. 20, 2017); PIABA 2017 Letter; Wells Fargo Letter; AARP Letter.

[98] *See* discussion *infra* Section II.D.2.d.2.

[99] *See* Exchange Act Section 15(k)(1) and Advisers Act Section 211(g)(1). *See also* 913 Study at 113.

[100] *Id.* Advisers Act Section 206(3) prohibits an adviser from engaging in a principal trade with an advisory client, unless it discloses to the client in writing before completion of the transaction the capacity in which the adviser is acting and obtains the consent of the client to the transaction.

[101] *Id.*

[102] *See* 913 Study at 113.

would be required to comply to satisfy its best interest obligation.

B. Best Interest, Generally

Proposed Regulation Best Interest uses the term ''best interest'' in several places. Under proposed paragraph (a)(1), broker-dealers would be required to ''act in the best interest of the retail customer . . . without placing the financial or other interest of'' the broker-dealer making the recommendation ''ahead of the interest of the retail customer.'' This general requirement would be satisfied through compliance with the four specific components of Regulation Best Interest set forth in paragraph (a)(2): The Disclosure Obligation described in Section II.D.1, the Care Obligation described in Section II.D.2 and the two prongs of the Conflict of Interest Obligations discussed in Section II.D.3. In addition, the term ''best interest'' is included in the Care Obligation, which would require, among other things, a broker-dealer to ''have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers,'' to ''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 and rewards associated with the recommendation,'' and ''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.''

The proposed best interest obligation, as defined by the Disclosure, Care, and Conflict of Interest Obligations below, encompasses and goes beyond a broker-dealer's existing suitability obligations.[103] As previously noted, one key difference between the Care Obligation imposed by Regulation Best Interest and the suitability obligation derived from the antifraud provisions of the federal securities laws is that the antifraud provisions require an element of fraud or deceit, which would not be required under Regulation Best Interest. More specifically, the Care Obligation could not be satisfied by disclosure. Second, as discussed below, our proposed interpretation of the Care Obligation would make the cost of the security or strategy, and any associated financial incentives, more important factors (of the many factors that should be considered) in understanding and analyzing whether to recommend a security or an investment strategy. Third, beyond the Care Obligation, Regulation Best Interest imposes Disclosure and Conflict of Interest Obligations that are intended to manage the potential impact that broker-dealer conflicts of interest may have on their recommendations.

We are not proposing to define ''best interest'' at this time. Instead, we preliminarily believe that whether a broker-dealer acted in the best interest of the retail customer when making a recommendation will turn on the facts and circumstances of the particular recommendation and the particular retail customer, along with the facts and circumstances of how the four specific components of Regulation Best Interest are satisfied. Furthermore, in the discussion below and in our discussion of each of these specific obligations, we provide further guidance regarding our views of how a broker-dealer could act in the best interest of the retail customer, including how a broker-dealer could make a recommendation in the ''best interest,'' and how it compares to existing broker-dealer obligations.

As a threshold matter, we recognize that it may be in a retail customer's best interest to allocate investments across a variety of investment products, or to invest in riskier or more costly products. We do not intend to limit through proposed Regulation Best Interest the diversity of products available, the higher cost or risks that may be presented by certain products, or the diversity in retail customers' portfolios. This proposal is not meant to effectively eliminate recommendations that encourage diversity in a retail customer's portfolio through investment in a wide range of products, such as actively managed mutual funds, variable annuities, and structured products. We recognize that these and other products that may involve higher risks or cost to the retail customer may be suitable under existing broker-dealer obligations. We believe these products could likewise continue to be recommended under Regulation Best Interest, if the broker-dealer satisfied its obligations under proposed Regulation Best Interest.

Rather, proposed Regulation Best Interest is designed to address the harm associated with broker-dealer incentives to recommend products for reasons that put the broker-dealer's interest ahead of the customer's interest (*e.g.,* because of higher compensation or other financial incentives for the broker-dealer). Nevertheless, we are sensitive to the potential that, in order to meet their obligations under the proposed Regulation Best Interest, broker-dealers may, for compliance and business reasons, determine to avoid offering certain products or limit recommendations to only certain low-cost and low-risk products that would appear on their face to satisfy the proposed best interest obligation. We emphasize that is not the intent of this proposal, and we request comment on the extent to which proposed Regulation Best Interest would result in broker-dealers limiting access to or eliminating certain products in a manner that could, in and of itself, cause harm to certain retail customers for whom those products are consistent with their investment objectives and in their best interest.

Specifically, as further clarification, proposed Regulation Best Interest would not *per se* prohibit a broker-dealer from transactions involving conflicts of interest, such as the following:

- Charging commissions or other transaction-based fees;
- Receiving or providing differential compensation based on the product sold;
- Receiving third-party compensation;
- Recommending proprietary products, products of affiliates or a limited range of products;
- Recommending a security underwritten by the broker-dealer or a broker-dealer affiliate, including initial public offerings (''IPOs'');
- Recommending a transaction to be executed in a principal capacity;
- Recommending complex products;
- Allocating trades and research, including allocating investment opportunities (*e.g.,* IPO allocations or proprietary research or advice) among different types of customers and between retail customers and the broker-dealer's own account;
- Considering cost to the broker-dealer of effecting the transaction or strategy on behalf of the customer (for example, the effort or cost of buying or selling an illiquid security); or
- Accepting a retail customer's order that is contrary to the broker-dealer's recommendations.

While these practices would not be *per se* prohibited by Regulation Best Interest, we are also not saying that these practices are *per se* consistent with Regulation Best Interest or other obligations under the federal securities laws. Rather, these practices, which generally involve conflicts of interest between the broker-dealer and the retail customer, would be permissible under Regulation Best Interest only to the extent that the broker-dealer satisfies the specific requirements of Regulation Best Interest.

While to satisfy proposed Regulation Best Interest, a broker-dealer would not

[103] *See* discussion *infra* Section II.D.

be required to analyze all possible securities, other products or investment strategies to find the single ''best'' security or investment strategy for the retail customer, broker-dealers generally should consider reasonably available alternatives offered by the broker-dealer as part of having a reasonable basis for making the recommendation, as required under the Care Obligation. Proposed Regulation Best Interest also would not necessarily obligate a broker-dealer to recommend the ''least expensive'' or the ''least remunerative'' security or investment strategy, provided the broker-dealer complies with the Disclosure, Care, and the Conflict of Interest Obligations set forth in the relevant sections below.[104]

As discussed in the Care Obligation below, we believe that the cost (including fees, compensation and other financial incentives) associated with a recommendation would generally be an important factor. However, there are also other factors that a broker-dealer should consider in determining whether a recommendation is in the best interest of a retail customer, as required by the Care Obligation. Other factors that would also be important to this determination include, among others, the product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks and potential benefits, volatility and likely performance in a variety of market and economic conditions.[105] While cost and financial incentives would generally be important, they may be outweighed by these other factors. Accordingly, we preliminarily believe that a broker-dealer would not satisfy its Care Obligation—and hence Regulation Best Interest—by simply recommending the least expensive or least remunerative security without any further analysis of these other factors and the retail customer's investment profile.

We preliminarily believe that, in order to meet its Care Obligation, when a broker-dealer recommends *a more expensive* security or investment strategy over another reasonably available alternative offered by the broker-dealer, the broker-dealer would need to have a reasonable basis to believe that the higher cost of the security or strategy is justified (and thus nevertheless in the retail customer's best interest) based on other factors (*e.g.,* the product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks and potential benefits, volatility and likely performance in a variety of market and economic conditions), in light of the retail customer's investment profile. When a broker-dealer recommends a *more remunerative* security or investment strategy over another reasonably available alternative offered by the broker-dealer, the broker-dealer would need to have a reasonable basis to believe that—putting aside the broker-dealer's financial incentives—the recommendation was in the best interest of the retail customer based on the factors noted above, in light of the retail customer's investment profile. Nevertheless, this does not mean that a broker-dealer could not recommend the more remunerative of two reasonably available alternatives, if the broker-dealer determines the products are otherwise both in the best interest of—and there is no material difference between them from the perspective of—the retail customer, in light of the retail customer's investment profile.

We preliminarily believe that under the Care Obligation, a broker-dealer could not have a reasonable basis to believe that a recommended security is in the best interest of a retail customer if it is more costly than a reasonably available alternative offered by the broker-dealer and the characteristics of the securities are otherwise identical, including any special or unusual features, liquidity, risks and potential benefits, volatility and likely performance.[106] Further, it would be inconsistent with the Care Obligation for the broker-dealer to recommend the more expensive alternative for the customer, even if the broker-dealer had disclosed that the product was higher cost and had policies and procedures in place that were reasonably designed to mitigate the conflict under the Conflict of Interest Obligations, as the broker-dealer would not have complied with its Care Obligation, as the higher cost of the security of would not be justified by the security's other characteristics in comparison to reasonably available alternatives (in contrast to the examples discussed below). By treating cost associated with a recommendation as an important factor in this analysis, the Care Obligation would enhance a broker-dealer's existing suitability obligations under the federal securities laws.

We believe that a broker-dealer would violate proposed Regulation Best Interest's Care Obligation and Conflict of Interest Obligations, if any recommendation was predominantly motivated by the broker-dealer's self-interest (*e.g.,* self-enrichment, self-dealing, or self-promotion), and not the customer's best interest—in other words, putting aside the broker-dealer's self-interest, the recommendation is not otherwise in the best interest of the retail customer based on other factors, in light of the retail customer's investment profile, and as compared to other reasonably available alternatives offered by the broker-dealer. Examples would include making a recommendation to a retail customer in order to: Maximize the broker-dealer's compensation (*e.g.,* commissions or other fees); further the broker-dealer's business relationships; satisfy firm sales quotas or other targets; or win a firm-

[104] As noted, *infra* Section II.C.2, Regulation Best Interest is intended to address concerns regarding the impact of material conflicts of interest, and the level of care exercised, when broker-dealers *recommend a security or investment strategy involving securities* to retail customers. Accordingly, proposed Regulation Best Interest applies only to recommendations, and the care exercised in making a recommendation and addressing the conflicts associated with a recommendation that may impact a broker-dealer's recommendation of a security or investment strategy, but would not apply to the execution of a recommended transaction or the potential conflicts of interest associated with executing a recommended transaction (*e.g.,* payments for order flow), which as discussed below are addressed by existing broker-dealer best execution, as well as other regulatory obligations. Under the antifraud provisions of the federal securities laws and SRO rules, broker-dealers have a legal duty to seek to obtain best execution of customer orders. *See* Regulation NMS, Exchange Act Release No. 51808 (June 9, 2005) (''Regulation NMS Release''); FINRA Rule 5310 (Best Execution and Interpositioning). A broker-dealer's duty of best execution requires a broker-dealer to seek to execute customers' trades at the most favorable terms reasonably available under the circumstances. *See* Regulation NMS Release at 160. In addition, Exchange Act Rules 10b–10, 606, and 607 require broker-dealers to disclose information about payment-for-order-flow arrangements to customers at the opening of a new account and, thereafter, on customer trade confirmations and in public quarterly reports. Proposed Regulation Best Interest would be separate from and would not alter these obligations, which apply when a broker-dealer executes a transaction, regardless of whether it was recommended. *See infra* Section II.D.1.d.2.

[105] *See* discussion *infra* Section II.D.1.

[106] An example of identical securities with different cost structures are mutual funds with different share classes. The Commission has historically charged broker-dealers with violating Sections 17(a)(2) and (3) of the Securities Act for making recommendations of more expensive mutual fund share classes while omitting material facts. *See, e.g., In re IFG Network Sec., Inc.,* Exchange Act Release No. 54127, at * 15 (July 11, 2006) (Commission Decision) (registered representative violated Sections 17(a)(2) and (3) by omitting to disclose to his customers material information concerning his compensation and its effect upon returns that made his recommendation that they purchase Class B shares misleading; ''The rate of return of an investment is important to a reasonable investor. In the context of multiple-share-class mutual funds, in which the only bases for the differences in rate of return between classes are the cost structures of investments in the two classes, information about this cost structure would accordingly be important to a reasonable investor.'').

sponsored sales contest.[107] We discuss possible methods of compliance with the Care Obligation and mitigation requirement in Section II.D. below.

On the other hand, the best interest obligation would allow a broker-dealer to recommend products that may entail higher costs or risks for the retail customer, or that may result in greater compensation to the broker-dealer than other products, or that may be more expensive, provided that the broker-dealer complies with the specific Disclosure, Care, and Conflict of Interest Obligations described in Section II.D.

1. Consistency With Other Approaches

a. DOL Fiduciary Rule and Related PTEs

We believe that the principles underlying our proposed best interest obligation as discussed above, and the specific Disclosure, Care, and Conflict of Interest Obligations described in more detail below, generally draw from underlying principles similar to the principles underlying the DOL's best interest standard, as described by the DOL in the BIC Exemption.[108] By choosing language that draws on similar principles to the principles underlying the DOL's ''best interest'' Impartial Conduct Standard, which would currently apply to broker-dealers relying on the BIC Exemption and or any of the related PTEs, we believe our proposed best interest standard would result in efficiencies for broker-dealers that have already established infrastructure to comply with the DOL best interest Impartial Conduct Standard. As we believe that at its core, the Best Interest Obligation is intended to achieve the same purpose as the best interest Impartial Conduct Standard, we preliminarily believe broker-dealers would be able to use the established infrastructure to meet any new obligations.

Under the DOL's standard, we understand that a recommendation could not be based on a broker-dealer's own financial interest in the transaction, nor could a broker-dealer recommend the investment unless it meets the objective prudent person standard of care.[109] As a general example, the DOL explained that under this standard, an adviser (such as a broker-dealer's registered representative), in choosing between two investments, could not select an investment because it is better for the adviser's bottom line even if it is a worse choice for the investor.[110]

Further, the proposed Disclosure Obligation, Care Obligation and Conflict of Interest Obligations described in more detail below, establish standards of professional conduct that, among other things, would require the broker-dealer to employ reasonable care when making a recommendation. According to the DOL, the BIC Exemption's best interest standard incorporates ''objective standards of care and undivided loyalty'' that would require adherence to a professional standard of care in making investment recommendations that are in the investor's best interest, and not basing recommendations on the advice-giver's own financial interest in the transaction, nor recommending an investment unless it meets the objective prudent person standard of care.[111]

Like our proposed best interest obligation, we understand that the DOL best interest standard as set forth in the BIC Exemption and in related PTEs, among other things, does not: Prohibit a broker-dealer from being paid, or receiving commissions or other transaction-based payments;[112] prohibit a broker-dealer from restricting recommendations in whole or in part to proprietary products and/or products that generate third-party payments[113] or engaging in ''riskless principal transactions''[114] or certain transactions on a principal basis;[115] require the identification of the single ''best'' investment;[116] nor impose an ongoing monitoring obligation, so long as the conditions under the BIC exemption or other applicable PTEs are satisfied.[117]

We understand that our proposed Regulation Best Interest does not reflect the other Impartial Conduct Standards that the broker-dealer: (1) Make no misleading statements; and (2) receive no more than reasonable compensation. We are not proposing standards similar to these Impartial Conduct Standards because existing broker-dealer obligations under the federal securities laws and SRO rules already prohibit misleading statements and require broker-dealers to receive only fair and reasonable compensation. Specifically, the antifraud provisions of the federal securities laws prohibit broker-dealers from making misleading statements.[118] In addition, FINRA rules address broker-dealers' communications with the public and specifically require broker-dealer communications to be based on principles of fair dealing and good faith and to be fair and balanced.[119] Furthermore, FINRA rules generally require broker-dealer prices for securities and compensation for services to be fair and reasonable taking into consideration all relevant circumstances.[120] For these reasons, we do not believe that including these two components of the DOL's Impartial Conduct Standards would add meaningful additional protections for retail customers. In contrast to proposed

[107] *See infra* note 321 and accompanying text.

[108] The BIC Exemption's best interest Impartial Conduct Standard would require (as here relevant) that advice be in a retirement investor's best interest, and further defines advice to be in the ''best interest'' if the person providing the advice acts ''with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with the such matters would use . . . without regard to the financial or other interests'' of the person. BIC Exemption Release, 81 FR at 21007, 21027. BIC Exemption Section II(c)(1); Section VIII(d).

[109] *Id.*

[110] *Id.*

[111] *Id.* at 21028.

[112] *See, e.g.,* BIC Exemption Release, 81 FR at 21032.

[113] We understand, however, that the BIC Exemption provides that a broker-dealer that restricts recommendations, in whole or in part, to proprietary products or investments that generate third-party payments, may rely on the exemption provided (among other conditions) the recommendation is prudent, the fees reasonable, the conflicts disclosed (so that the customer can fairly be said to have knowingly assented to the compensation arrangement), and the conflicts are managed through stringent policies and procedures that keep the focus on the customer's best interest, rather than any competing financial interest. *See* BIC Exemption, Section IV; BIC Exemption Release, 81 FR at 21029, 21052–57.

[114] The BIC Exemption provides exemptive relief (if all applicable conditions are met) for compensation received as part of riskless principal transactions, which are defined as ''a transaction in which a Financial Institution, after having received an order from a Retirement Investor to buy or sell an investment product, purchases or sells the same investment product for the Financial Institution's own account to offset the contemporaneous transaction with the Retirement Investor.'' *See* BIC Exemption Release, 81 FR at 21016, 21064. The DOL provided a separate exemption for investment advice fiduciaries to engage in principal transactions involving specified investments, but subject to additional protective conditions. *See* Principal Transactions Exemption.

[115] Separate from the BIC Exemption, the DOL granted a new exemption for certain principal transactions, which permits ERISA fiduciaries to sell or purchase certain debt securities and other investments in principal transactions and riskless principal transactions with plans and IRAs under certain conditions. *See* Principal Transactions Exemption. Among other conditions, this exemption requires adherence to Impartial Conduct Standards identical to those in the BIC Exemption, including to provide advice in the ''best interest'' as defined above, with the exception that the Principal Transactions Exemption specifically refers to the fiduciary's obligation to seek to obtain the best execution reasonably available under the circumstances with respect to the transaction, rather than to receive no more than ''reasonable compensation.'' *See id.*

[116] BIC Exemption Release, 81 FR at 21029.

[117] *Id.*

[118] *See, e.g.,* Exchange Act Sections 10(b) and 15(c).

[119] *See* FINRA Rule 2210 (Communications with the Public).

[120] *See, e.g.,* FINRA Rules 2121 (Fair Prices and Commissions), 2122 (Charges for Services Performed), and 2341 (Investment Company Securities). *See also* Exchange Act Sections 10(b) and 15(c).

Regulation Best Interest, which would add enhancements to existing broker-dealer obligations, we believe proposing new rules addressing areas already covered by the federal securities laws and SRO rules—without also enhancing those obligations—may cause confusion about how these new obligations would differ from current requirements.

b. Recommendations of 913 Study

Our proposed Regulation Best Interest diverges from the recommendation of the 913 Study, in that it does not propose to establish a uniform fiduciary standard of conduct for both investment advisers and broker-dealers, but rather focuses on establishing a best interest obligation for broker-dealers.[121] The 913 Study recommended that the Commission consider rulemakings that would apply expressly and uniformly to both broker-dealers and investment advisers, when providing personalized investment advice about securities to retail customers, a fiduciary standard no less stringent than currently applied to investment advisers under Advisers Act Sections 206(1) and (2), which the staff interpreted ''to include at a minimum, the duties of loyalty and care as interpreted and developed under Advisers Act Section 206(1) and 206(2).'' Specifically, the 913 Study recommended that the Commission should establish a uniform fiduciary standard of conduct requiring broker-dealers and investment advisers, ''when providing personalized investment advice about securities to retail customers . . . to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.'' Further, the Study recommended that the Commission engage in rulemaking and/or issue interpretive guidance addressing the components of the uniform fiduciary standard: The duties of loyalty (*e.g.,* disclosure and potentially prohibition and mitigation of certain conflicts) and care (*e.g.,* suitability).[122]

We have given extensive consideration to the 913 Study recommendation related to a uniform fiduciary standard of conduct, the information that the public has submitted over the years following the 913 Study, and our extensive experience regulating broker-dealers and investment advisers. Based on our evaluation, we have determined at this time to propose a more tailored approach focusing on enhancements to broker-dealer regulation to address our current concerns. We preliminarily believe it makes more sense to build upon this regulatory regime and the underlying expertise, and in this way reflect the unique characteristics of the relationship (*e.g.,* its transaction-based nature, the variety of services the broker-dealer may provide, which may or may not involve advice, and that the broker-dealer may provide services in a principal or agent capacity), rather than to create a new standard out of whole cloth or simply adopt obligations and duties that have developed under a separate regulatory regime to address a different type of advice relationship (*e.g.,* a relationship that exists primarily for the provision of advice about investments, and typically involves portfolio management, often on a discretionary basis[123]).[124]

Nevertheless, the recommendations of the 913 Study were useful to us in evaluating how to specifically enhance investor protection and improve the obligations that apply to broker-dealers when making recommendations to retail customers. While we are not proposing a uniform fiduciary standard, as recommended in the 913 Study, we nevertheless preliminarily believe that the proposed best interest obligation draws from principles underlying and reflects the underlying intent of many of the recommendations of the 913 Study. As a consequence, we also believe the rule draws upon the duties of loyalty and care as interpreted under Section 206(1) and (2) of Advisers Act, even if not the same as the 913 Study recommendations or the duties interpreted under the Advisers Act.[125]

As discussed above, our proposed best interest obligation would generally track key elements of both the language of Section 913 of the Dodd-Frank Act and the 913 Study recommendation for the wording of a uniform fiduciary standard (with the exception of the proposed replacement of ''without regard to'' language), and would reflect the principles underlying the 913 Study recommendations related to a uniform fiduciary standard of conduct.

Specifically, as noted, the 913 Study recommended that the Commission engage in rulemaking and/or issue interpretive guidance addressing the components of the uniform fiduciary standard: The duties of loyalty (*e.g.,* disclosure and potentially prohibition and mitigation of certain conflicts) and care (*e.g.,* suitability). As discussed in more detail in the relevant sections below, in framing the recommended duties of loyalty and care under the recommended uniform fiduciary standard of conduct, the 913 Study looked to the duties of loyalty and care under the Advisers Act as a baseline for the uniform fiduciary standard—consistent with the ''no less stringent'' mandate of Section 913(g). For example, in framing the duty of loyalty under the recommended uniform fiduciary standard of conduct, the 913 Study stated that by reference to Advisers Act Section 206(1) and 206(2), the duty of loyalty would require an investment adviser or broker-dealer ''to eliminate, or provide full and fair disclosure about its material conflicts of interest.''[126]

Further, taking into consideration the express provisions of Section 913(g) of the Dodd-Frank Act, the 913 Study explains that the recommended uniform standard would neither require the absolute elimination of any particular conflicts (in the absence of another requirement to do so) nor impose on broker-dealers a continuing duty of loyalty or care; nor would the receipt of commissions or other standard compensation, sale of proprietary products, or engaging in transactions on a principal basis, in and of themselves, violate the fiduciary standard.[127] Similarly, in framing the duty of care under the recommended uniform fiduciary standard of conduct, the 913 Study considered the duty of care obligations interpreted under the Advisers Act and current broker-dealer conduct obligations, in recommending that the Commission consider specifying uniform, minimum standards for the duty of care.[128] The 913 Study noted that the Commission could articulate such minimum standards by referring to and expanding upon, as appropriate, the explicit minimum standards of conduct relating to the duty

[121] We note that proposed Regulation Best Interest only addresses issues related to the 913 Study's recommendations regarding a standard of conduct for broker-dealers, and does not involve unrelated recommendations of the 913 Study, notably, the recommendations relating to harmonization of the legal frameworks governing broker-dealers and investment advisers more generally. *See* 913 Study at 129 *et seq.* In a separate concurrent release, we request comment on whether there should be certain potential enhancements to investment advisers' legal obligations by looking to areas where the current broker-dealer framework provides investor protections that may not have counterparts in the investment adviser context. *See* Fiduciary Duty Interpretive Release.

[122] *See generally* 913 Study at 110–23.

[123] Many investment advisers manage portfolios for retail investors and exercise investment discretion over the accounts, while others provide advice to non-discretionary accounts, provide financial planning, and sponsor or act as portfolio managers in wrap fee programs. *See, e.g.,* 913 Study.

[124] *See* discussion *infra* Section II.F.

[125] *See* Fiduciary Duty Interpretive Release.

[126] *See* 913 Study at 112–13.

[127] *See* 913 Study at 113.

[128] *See* 913 Study at 120–21.

of care applicable to broker-dealers (*e.g.,* suitability), and could also take into account Advisers Act principles related to the duty of care (*e.g.,* duty to provide suitable investment advice).[129]

We believe the proposed best interest obligation reflects many of these same principles of what would be required or prohibited under the uniform standard recommended by the 913 Study, as discussed above. In addition, as discussed in Section II.D, consistent with the 913 Study recommendation, to satisfy our proposed best interest obligation, we are proposing that broker-dealers must comply with specific requirements: Namely, the Disclosure, Care and Conflict of Interest Obligations. This specificity is intended to both: (1) Provide clarity to broker-dealers about their obligations under Regulation Best Interest generally and how they relate to existing obligations when making recommendations (*i.e.,* suitability); and (2) particularly address the material conflicts of interest resulting from financial incentives. As we discuss in more detail in the relevant sections specifically addressing these obligations, we believe the Disclosure, Care and Conflict of Interest Obligations generally draw from principles underlying the duties of care and loyalty as recommended in the 913 Study,[130] while having the specific regulatory obligations reflect the unique structure and characteristics of broker-dealer relationships with retail customers.

2. Request for Comment on the Best Interest Obligation

The Commission requests comment on defining the proposed best interest obligation to require broker-dealers ''to act in the best interest of the retail customer . . . without placing the financial or other interest of the [broker-dealer] making the recommendation ahead of the interest of the retail customer,'' as well as comment on the application of this standard and the types of practices that would be consistent or inconsistent with this standard.

- Do commenters believe that we should adopt a best interest obligation for broker-dealers?
- Do commenters agree with the general approach of the best interest obligation of building on existing requirements? Are there alternative approaches or additional steps that the Commission should take? If so, what?
- Would the Best Interest Obligation cause a broker-dealer to act in a manner that is consistent with what a retail customer would reasonably expect from someone who is required to act in their best interest? If so, how? If not, what further steps should the Commission take? Why or why not?
- Does the obligation enhance retail customer protection? If so, how? If not, what further steps should the Commission take? Why or why not?
- Do commenters agree with our assessment of how the Best Interest Obligation compares with the DOL's best interest Impartial Conduct Standard, as incorporated in the BIC Exemption? Do commenters believe that proposed Regulation Best Interest provides similar protections to the DOL's best interest Impartial Conduct Standard, as incorporated in the BIC Exemption? If not, what are the differences and what impact would those differences have on retail customers? Do commenters believe it would be desirable to maintain consistency with the DOL requirements and guidance in this area, as set forth in the BIC exemption?
- As discussed herein, we propose that the best interest obligation would require a broker-dealer, when making a recommendation, not to put the interests of a broker-dealer or its associated persons ahead of the retail customer's interest. Does this formulation meet the Commission's goal of protecting retail customers and clarifying the standards that apply when broker-dealers are providing advice?
- It is our intent that our proposal would make it clear that, insofar as existing broker-dealer obligations have been interpreted to stand for the principle that broker-dealers may put their own interests ahead of their retail customers' when making a recommendation, those interpretations would be inconsistent with Regulation Best Interest. Does the rule text achieve this objective? To the extent that it does not, or it does not do so with appropriate clarity and certainty, what changes could be made to the proposed rule? Should we provide a clarifying note?
- To best capture this obligation, we are proposing that a broker-dealer must act in the best interest of the retail customer ''without placing the financial or other interest of the [broker-dealer] making the recommendation ahead of the interest of the retail customer.'' Do commenters agree with our proposed approach, or should the Commission take an alternative approach, such as provide that to act in the best interest, a broker-dealer must act in the best interest of the retail customer ''without regard to the financial or other interest of the [broker-dealer] making the recommendation'' or ''by placing the interest of the retail customer ahead of the broker-dealer''? Why or why not? What practical impact would the inclusion or exclusion of the Commission's proposed approach or the potential alternative approach have on the obligations of the proposed best interest obligation as described? Will it lead to retail customer confusion? Would courts interpret the standard differently? Is there different language that the Commission should consider?
- Should the Commission provide further guidance on the proposed best interest obligation? Should the guidance be with respect to particular transactions or relationships? If so, please provide examples of scenarios that should be deemed to meet or not meet this standard.
- Are the guidance and interpretations provided by the Commission appropriate? Should any of it be included in the rule text? Please be specific.
- Should the Commission define the term ''best interest'' in the rule text? Should the Commission define ''best interest'' with respect to particular transactions or relationships? If so, what definitions should the Commission consider and why? What are the advantages and disadvantages of any proposed alternatives in this context? Please explain with specificity what duties any suggested definitions would entail.
- Do commenters agree with the Commission's guidance on what practices should not be *per se* prohibited by Regulation Best Interest (provided the terms of the proposed rule are satisfied)? Why or why not? Should any of these practices be *per se* prohibited? Why or why not?
- Do commenters agree with our view that recommending a more expensive or more remunerative alternative for identical securities would be inconsistent with Regulation Best Interest? Are there any additional practices that the Commission should specifically identify as consistent or inconsistent with Regulation Best Interest? Please identify any such practices and why they should be viewed as consistent or inconsistent with this obligation.
- Are any changes in Regulation Best Interest necessary to make it clear that broker-dealers who offered a limited scope of products nevertheless can satisfy the standard?
- Do commenters believe that proposed Regulation Best Interest would result in broker-dealers limiting access to or eliminating certain products in a

[129] *See* 913 Study at 121.

[130] *See infra* discussion in Section II.D.1 and 2 comparing the Care and Conflict recommendations of the 913 Study.

manner that could, in and of itself, cause harm to certain retail customers for whom those products are consistent with their investment objectives and in their best interest? If so, what products do commenters think would be limited or eliminated? Would any changes in Regulation Best Interest minimize or avoid these outcomes?

- Do commenters believe that our proposed rule is sufficiently clear that a broker-dealer is not required to monitor a retail customer's account as part of its obligations unless specifically contracted for? If not, what modifications should be made to Regulation Best Interest? Do commenters believe that retail customers understand that a broker-dealer is not required to monitor retail customers' accounts? If so, what is the basis for that understanding (*e.g.,* firm disclosures)? What specific obligations do broker-dealers typically take on if they contract to monitor customer accounts?
- Should Regulation Best Interest apply when broker-dealers agree to provide ongoing monitoring of the retail customer's investment for purposes of recommending changes in investments? Why or why not? Alternatively, should broker-dealers who provide ongoing monitoring be considered investment advisers?
- Do commenters agree with the Commission's assessment that no new private right of action or right of rescission is created by Regulation Best Interest?
- Despite the Commission's assertion that Regulation Best Interest is limited to broker-dealers and is not intended to impact the fiduciary obligations under the Advisers Act, do commenters have concerns regarding the potential impact of this best interest obligation on the legal obligations under other standards? If so, what are these concerns? Do commenters have any suggestions on how to provide further clarification on this issue?
- In defining a broker-dealer's obligation when making a recommendation to a retail customer, the Commission is not proposing to impose additional requirements, such as requirements related to the receipt of fair and reasonable compensation or the prohibition against misleading statements that are part of DOL's Impartial Conduct Standards, because broker-dealers already have these obligations. Should the Commission consider incorporating these or other requirements into the proposed rule? If so, what requirements should be added and why? How should those requirements be defined? How would the suggested requirements be different from current broker-dealer obligations and enhance investor protection? To the extent broker-dealers already have existing obligations related to suggested additional requirements, should the Commission consider modifying the existing broker-dealer regulatory obligations, and if so, how?
- Do commenters agree with our proposed approach of a tailored standard for broker-dealers as opposed to a uniform standard of conduct for both broker-dealers and investment advisers?
- Do commenters believe that we should explicitly adopt FINRA's suitability standard, and then add any desired changed or enhancements to that standard, in order to simplify the best interest obligation? Are there specific benefits or problems with that approach?

C. Key Terms and Scope of Best Interest Obligation

1. Natural Person Who Is an Associated Person

The Commission proposes to define ''natural person who is an associated person'' as a natural person who is an associated person as defined under Section 3(a)(18) of the Exchange Act: ''any partner, officer, director or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of section 15(b) of this title (other than paragraph 6 thereof).''

In defining in this manner, we intend to require not only the broker-dealer entity, but also individuals that are associated persons of a broker-dealer (*e.g.,* registered representatives) to comply with specified components of Regulation Best Interest when making recommendations, as described below. We have limited the definition only to a ''natural person who is an associated person'' to avoid the application of Regulation Best Interest to ''all associated persons of a broker-dealer,'' as the latter definition would capture affiliated entities of the broker-dealer and would extend the application of Regulation Best Interest to entities that are not themselves broker-dealers, which are not our intended focus.

2. When Making a Recommendation, at Time Recommendation Is Made

The Commission proposes that Regulation Best Interest would apply when a broker-dealer is making a recommendation about any securities transaction or investment strategy to a retail customer (as defined and discussed below). We believe that by applying Regulation Best Interest to a ''recommendation,'' as that term is currently interpreted under broker-dealer regulation, we would provide clarity to broker-dealers and their retail customers as to when Regulation Best Interest applies and maintain efficiencies for broker-dealers that have already established infrastructures to comply with suitability obligations. Moreover, we believe that taking an approach that is driven by each recommendation would appropriately capture and reflect the various types of advice broker-dealers provide to retail customers, whether on an episodic, periodic, or more frequent basis and help ensure that customers receive the protections that Regulation Best Interest is intended to provide.

The proposed rule relies in part on the statutory authority provided in Section 913(f) of the Dodd-Frank Act, which provides the Commission rulemaking authority to address the standards of care ''for providing personalized investment advice about securities to such retail customers.'' [131] As noted in the 913 Study, Section 913 of the Dodd-Frank Act does not define ''personalized investment advice,'' and the broker-dealer regulatory regime does not use the term ''investment advice'' but instead focuses on whether a broker-dealer has made a ''recommendation.'' [132] The 913 Study recommended that the definition of ''personalized investment advice'' should at a minimum encompass the making of a ''recommendation'' as developed under applicable broker-dealer regulation.[133] Given that proposed Regulation Best Interest is focused on broker-dealer standards of conduct, and recognizing that the term ''personalized investment advice'' is not used in the broker-dealer regulatory regime, we propose that, consistent with

[131] *See* Section 913(f) of the Dodd-Frank Act.

[132] *See* 913 Study at 123–24.

[133] *Id.* at 127. The 913 Study also indicated that beyond that, ''the term also could include any other actions or communications that would be considered investment advice about securities under the Advisers Act (such as comparisons of securities or asset allocation strategies), *except for* 'impersonal investment advice' as developed under the Advisers Act.'' *Id.* (emphasis in original). As noted below, we are seeking comment on alternative definitions and the scope of the term ''recommendation.''

broker-dealer regulation and in recognition of the 913 Study recommendation, proposed Regulation Best Interest would apply to a ''recommendation,'' as discussed below.[134]

a. Scope of Recommendation

The Commission believes that the determination of whether a recommendation has been made to a retail customer that triggers the best interest obligation should be interpreted consistent with existing broker-dealer regulation under the federal securities laws and SRO rules, which would provide clarity to broker-dealers and maintain efficiencies for broker-dealers with established infrastructures that already rely on this term.[135] In addition, the Commission believes that whether a recommendation has been made should, also consistent with existing broker-dealer regulation, turn on the facts and circumstances of the particular situation, and therefore, whether a recommendation has taken place is not susceptible to a bright line definition.[136] We believe that the meaning of the term ''recommendation'' is well-established and familiar to broker-dealers, and we believe that the same meaning should be ascribed to the term in this context. We are concerned that even providing a principles-based definition, which draws upon the principles underlying existing Commission precedent and guidance, may create unnecessary confusion as to whether the language intentionally or unintentionally diverges from existing precedent. As we are not proposing to make any changes to this existing precedent and guidance regarding when a recommendation is made, we preliminarily believe that it is not necessary or appropriate to define it for purposes of the proposed rule.

In determining whether a broker-dealer has made a recommendation, factors that have historically been considered in the context of broker-dealer suitability obligations include whether the communication ''reasonably could be viewed as a 'call to action' '' and ''reasonably would influence an investor to trade a particular security or group of securities.'' [137] The more individually tailored the communication to a specific customer or a targeted group of customers about a security or group of securities, the greater the likelihood that the communication may be viewed as a ''recommendation.''

Consistent with existing broker-dealer suitability obligations, certain communications under this approach would generally be excluded from the meaning of ''recommendation'' as long as they do not include (standing alone or in combination with other communications), a recommendation of a particular security or securities. For example, as recognized under existing broker-dealer regulation, excluded communications would include providing general investor education (*e.g.,* a brochure discussing asset allocation strategies) or limited investment analysis tools (*e.g.,* a retirement savings calculator).[138]

Consistent with existing interpretations and guidance of what constitutes a recommendation, the obligation would apply to activity that has been interpreted as ''implicit

[134] *See* ICI August 2017 Letter (''We note that because we are suggesting a distinct best interest standard of conduct for broker-dealers, and that the FINRA definition of 'recommendation' should apply, the term 'personalized investment advice,' which the SEC used in its 2013 request for data, would not be applicable, as that term was intended to encompass both 'recommendations' under the FINRA rules and 'investment advice' under the Advisers Act.'').

[135] *See, e.g.,* FINRA Regulatory Notice 12–25 at Q2 and Q3 (regarding the scope of ''recommendation''); *see also Michael F. Siegel,* Exchange Act Release No. 58737, at *21–27 (Oct. 6, 2008) (Commission opinion, sustaining NASD findings) (applying FINRA's guiding principles to determine that a recommendation was made), *aff'd in relevant part, Siegel* v. *SEC,* 592 F.3d 147 (D.C. Cir. 2010), *cert. denied,* 560 U.S. 926 (2010); *In re Application of Paul C. Kettler,* Exchange Act Release No. 31354 at 5, n.11 (Oct. 26, 1992). Some commenters agreed that the Commission should use FINRA's definition and guidance of recommendation in establishing a standard of conduct for broker-dealers. *See* AFL–CIO Letter (''Because DOL relied on FINRA guidance with regard to what constitutes a recommendation, the SEC could simply adopt that same definition for its own rulemaking purposes''); Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America (Sept. 14, 2017) (''CFA'') (''While the determination of whether a recommendation has been made will always be based on the particular facts and circumstances, FINRA guidelines provide a sound basis for such a definition.''). *See also* Business Conduct Standards Adopting Release.

[136] This approach to whether a ''recommendation'' has occurred is consistent with the approach the Commission has taken in other contexts. *See* Business Conduct Standards Adopting Release at 156.

[137] *See* FINRA Notice to Members 01–23, Online Suitability (Mar. 19, 2001), and Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook, Exchange Act Release No. 62718 (Aug. 13, 2010), 75 FR 51310 (Aug. 19, 2010), as amended, Exchange Act Release No. 62718A (Aug. 20, 2010), 75 FR 52562 (Aug. 26, 2010) (discussing what it means to make a ''recommendation''); FINRA Regulatory Notice 11–02, Know Your Customer and Suitability (Jan. 2011) (discussing how to determine the existence of a recommendation), and FINRA Regulatory Notice 12–25 at n.24 (citing FINRA Regulatory Notices discussing principles on determining whether a communication is a ''recommendation''). *See also Michael F. Siegel,* Exchange Act Release No. 58737, at *11 (Oct. 6, 2008) (Commission opinion, sustaining NASD findings) (applying FINRA principles to facts of case to find a recommendation), *aff'd in relevant part, Siegel* v. *SEC,* 592 F.3d 147 (D.C. Cir. 2010), *cert. denied,* 560 U.S. 926 (2010).

The DOL Fiduciary Rule follows a consistent approach in defining a ''recommendation'' as a ''communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the [advice] recipient engage in or refrain from taking a particular course of action.'' *See* DOL Fiduciary Rule Release, 81 FR 20945, 20972 (''The Department, however, as described both here and elsewhere in the preamble, has taken an approach to defining ''recommendation'' that is consistent with and based on FINRA's approach''); U.S. Department of Labor, Employee Benefits Security Administration, Conflict of Interest FAQs, Part II—Rule (Jan. 2017) Q1 (discussing what types of communication constitute a ''recommendation''), *available at https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-2.pdf* (''DOL FAQs Part II'').

We understand concerns have been expressed that the DOL Fiduciary Rule covers a broader range of communications as ''fiduciary investment advice.'' We are mindful of such concerns and therefore, propose to interpret what is a recommendation consistent with existing guidance under the federal securities laws and SRO rules. *See, e.g.,* Letter from Lisa Bleier, Managing Director & Associate General Counsel, SIFMA in response to DOL's Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions (Aug. 9, 2017); Letter from Lisa Bleier, Managing Director & Associate General Counsel, SIFMA, in response to RIN 1210–AB79; Proposed Delay and Reconsideration of DOL Regulation Redefining the Term ''Fiduciary'' (Apr. 17, 2017) (expressing concerns regarding the breadth of what is considered fiduciary investment advice under the DOL Fiduciary Rulemaking and advocating for an approach that ''would build upon, and fit seamlessly within, the existing and long-standing securities regulatory regime for broker-dealers'').

[138] *See* FINRA Rule 2111.03 (excluding the following communications from the coverage of Rule 2111 as long as they do not include (standing alone or in combination with other communications) a recommendation of a particular security or securities: (a) General financial and investment information, including (i) basic investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment, (ii) historic differences in the return of asset classes (*e.g.,* equities, bonds, or cash) based on standard market indices, (iii) effects of inflation, (iv) estimates of future retirement income needs, and (v) an assessment of a customer's investment profile; (b) Descriptive information about an employer-sponsored retirement or benefit plan, participation in the plan, the benefits of plan participation, and the investment options available under the plan; (c) Asset allocation models that are (i) based on generally accepted investment theory, (ii) accompanied by disclosures of all material facts and assumptions that may affect a reasonable investor's assessment of the asset allocation model or any report generated by such model, and (iii) in compliance with Rule 2214 (Requirements for the Use of Investment Analysis Tools) if the asset allocation model is an ''investment analysis tool'' covered by Rule 2214; and (d) Interactive investment materials that incorporate the above. The DOL takes a similar approach, excluding from the term ''recommendation,'' among other things, general communications and investment education (including plan information, general financial, investment and retirement information, asset allocation models and interactive investment materials). *See* 29 CFR 2510.3–21(b); DOL Fiduciary Rule Release, 81 FR 20945, 20971; DOL FAQs Part II; Definition of Recommendation.

recommendations.'' [139] For example, certain transactions that a broker-dealer executes on a retail customer's behalf, even if not separately authorized, have been interpreted as implicit recommendations that can trigger suitability obligations.[140] We propose that, consistent with existing interpretations and guidance of what constitutes a recommendation, as well as Exchange Act and SRO rules addressing broker-dealer regulation of discretionary accounts,[141] the obligation to act in the customer's best interest should apply consistently to any recommendation, whether through the execution of discretionary transactions (considered to be implicitly recommended) or when making a recommendation to a brokerage customer in a non-discretionary account.[142]

b. Duration of Obligation and Effect of Contractual Arrangements/Course of Dealing

Regulation Best Interest would be triggered ''when making'' a recommendation and a broker-dealer would be required to act in the best interest ''at the time the recommendation is made.'' The proposed rule is intended to focus the obligation to each particular instance when a recommendation is made to a retail customer and whether the broker-dealer satisfied its best interest obligation (*i.e.,* was in compliance with the specific Disclosure, Care, and Conflict of Interest Obligations) at the time of the recommendation. The proposed rule is not intended to change the varied advice relationships that currently exist between a broker-dealer and its retail customers, ranging from one-time, episodic or more frequent advice,[143] consistent with the goal of enhancing investor protection while preserving retail customer access to and choice in advice relationships.

Accordingly, the best interest obligation would not, for example: (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 the performance of the account;[144] (2) require the broker-dealer to refuse to accept a customer's order that is contrary to a broker-dealer's recommendations; or (3) apply to self-directed or otherwise unsolicited transactions by a retail customer, who may also receive other recommendations from the broker-dealer.[145]

We recognize, however, that a broker-dealer may agree with a retail customer by contract to take on additional obligations beyond those imposed by Regulation Best Interest, for example, by agreeing with a retail customer to hold itself to fiduciary duties, or to provide periodic or ongoing services (such as ongoing monitoring of the retail customer's investments for purposes of recommending changes in investments).[146] To the extent that the broker-dealer takes on such obligations, Regulation Best Interest would apply to, and a broker-dealer would be liable for not complying with the proposed rule with respect to, any *recommendations* about securities or investment strategies made to retail customers resulting from such services. However, the best interest obligation does not impose new obligations with respect to the additional services, provided that they do not involve a recommendation to retail customers. Importantly, as noted above, Regulation Best Interest would not alter a broker-dealer's existing obligations under the Exchange Act or any other applicable provisions of the

[139] *See, e.g.,* FINRA Regulatory Notice 12–25 at Q3 (regarding the scope of ''implicit recommendation''); *see also infra* Section II. F for further discussion.

[140] *See, e.g.,* Rafael Pinchas, 54 SEC. 331, 341 n.22, 1999 SEC LEXIS 1754, at *20 n.22 (1999) (''Transactions that were not specifically authorized by a client but were executed on the client's behalf are considered to have been implicitly recommended within the meaning of [FINRA's suitability rule].'').

[141] The Exchange Act addresses manipulative, deceptive, or fraudulent practices with respect to discretionary accounts. *See* Exchange Act Rule 15c1–7 (Discretionary Accounts); Exchange Act Section 3(a)(35) (defining when a person exercises ''investment discretion'' with respect to an account). *See also* NASD Rule 2510 (Discretionary Accounts) and Incorporated NYSE Rule 408 (Discretionary Power in Customers' Accounts). These rules address the obligations that apply to members that have discretionary power over a customer's account, such as the requirement to obtain customer authorization prior to exercising discretion and to conduct supervisory reviews of discretionary accounts. FINRA has adopted additional rules governing discretionary account requirements for specific products and scenarios. *See, e.g.,* FINRA Rule 5121 (Public Offerings of Securities With Conflicts of Interest) (subpart (c) relating to discretionary accounts); FINRA Rule 4512 (Customer Account Information) (subpart (a)(3) relating to discretionary accounts). These rules are in addition to rules, such as FINRA Rule 2111, that apply to any recommendation. *See also* Section II.F. for a discussion and request for comment regarding broker-dealer exercise of discretion and the extent to which such exercise is ''solely incidental'' to the conduct of its business as a broker-dealer.

[142] *See, e.g.,* Paul C. Kettler, 51 SEC. 30, 32 n.11, 1992 SEC LEXIS 2750, at *5 n.11 (1992) (stating that transactions a broker effects for a discretionary account are implicitly recommended). A number of commenters focused on addressing the standard that applied to ''non-discretionary'' recommendations. *See, e.g.,* SIFMA 2017 Letter (noting that ''BDs, on the other hand, provide non-discretionary recommendations. BDs generally cannot trade on their client's behalf; clients must authorize any transactions'' and suggesting that the definition of the term ''recommendation'' be limited to ''non-discretionary recommendations''); T. Rowe Letter (''Given the history, we believe that the SEC's best path forward would be to focus specifically on updating the standard applicable to non-discretionary broker-dealer recommendations, irrespective of account type.''). *But see* Letter from Ronald P. Bernardi, President and Chief Executive officer, Bernardi Securities, Inc. (Sept. 11, 2017) (''Bernardi Letter'') (suggesting consideration of a ''Best Interest Standard'' that ''would apply to all non-discretionary (self-directed) and discretionary transaction-based, broker-dealer relationships.''). *See also infra* Section II.F.

[143] To that end, the intent of the proposed rule is to impose a best interest obligation on a broker-dealer when engaging in a very specific activity—the making of a recommendation to a retail customer (as defined below)—and to define the contours of that obligation. The rule is not intended to supersede the body of case law holding that broker-dealers that exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers, owe customers a fiduciary duty, or the scope of obligations that attach by virtue of that duty. *See, e.g., U.S.* v. *Skelly,* 442 F.3d 94, 98 (2d Cir. 2006) (fiduciary duty found ''most commonly'' where ''a broker has discretionary authority over the customer's account''); *United States* v. *Szur,* 289 F.3d 200, 211 (2d Cir. 2002) (''Although it is true that there 'is no general fiduciary duty inherent in an ordinary broker/customer relationship,' a relationship of trust and confidence does exist between a broker and a customer with respect to those matters that have been entrusted to the broker.'') (citations omitted); *Leib* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 461 F. Supp. 951, 953–954 (E.D. Mich. 1978), *aff'd,* 647 F.2d 165 (6th Cir. 1981) (recognizing that a broker who has de facto control over non-discretionary account generally owes customer duties of a fiduciary nature; looking to customer's sophistication, and the degree of trust and confidence in the relationship, among other things, to determine duties owed); *Arleen W. Hughes,* Exchange Act Release No. 4048 (Feb. 18, 1948) (Commission Opinion), *aff'd sub nom. Hughes* v. *SEC,* 174 F.2d 969 (D.C. Cir. 1949) (''Release 4048'') (noting that fiduciary requirements generally are not imposed upon broker-dealers who render investment advice as an incident to their brokerage unless they have placed themselves in a position of trust and confidence, and finding that Hughes was in a relationship of trust and confidence with her clients). Such broker-dealers would continue to have such fiduciary duties, subject to liability under the antifraud provisions of the federal securities laws, in addition to the express requirements of the proposed rule. *See also infra* Section II.F. for a discussion and request for comment regarding broker-dealer exercise of discretion and the extent to which such exercise is ''solely incidental'' to the conduct of its business as a broker-dealer.

[144] Regulation Best Interest would not alter or diminish broker-dealers' current supervisory obligations under the Exchange Act and detailed SRO rules, including the establishment of policies and procedures reasonably designed to prevent and detect violations of, and to achieve compliance with, the federal securities laws and regulations, as well as applicable SRO rules. *See* Exchange Act Section 15(b)(4)(E); FINRA Rule 3110.

[145] Under existing broker-dealer regulatory obligations, broker-dealers have an obligation to accurately record all recommended transactions as ''solicited.'' *See* Exchange Act Rule 17a–3(a)(6)–(7); Exchange Act Rule 17a–25(a)(2). We are not proposing any changes to these compliance requirements.

[146] *See infra* Section II.D.1.

federal securities laws and rules and regulations.[147]

In addition, under Section 29(a) of the Exchange Act, a broker-dealer would not be able to waive compliance with the rule's obligation to act in the best interest of the retail customer at the time a recommendation is made and the specific obligations thereunder, nor can a retail customer agree to waive her protection under Regulation Best Interest. Thus, the scope of Regulation Best Interest cannot be reduced by contract.

Furthermore, in addition to furthering our goal of enhancing investor protection while preserving retail customer access to and choice of advice relationships, we believe that applying the best interest obligation to when a broker-dealer is making a recommendation generally would be consistent with the DOL's approach under the DOL Fiduciary Rule and the BIC Exemption. The DOL states that the BIC Exemption ''does not mandate an ongoing or long-term advisory relationship, but rather leaves the duration of the relationship to the parties.'' [148] Consistent with the DOL's interpretation of a fiduciary's monitoring responsibility in the preamble to the DOL Fiduciary Rule,[149] the BIC Exemption requires broker-dealers, among others, to disclose whether or not they will monitor an investor's investments and alert the investor to any recommended changes to those investments and, if so, the frequency with which the monitoring will occur and the reasons for which the investor will be alerted.[150] The DOL does not require broker-dealers to provide advice on an ongoing, rather than transactional, basis.[151] Specifically, ''[t]he terms of the contract or disclosure along with other representations, agreements, or understandings between the Adviser, Financial Institution and Retirement Investor, will govern whether the nature of the relationship between the parties is ongoing or not.'' [152]

3. Any Securities Transaction or Investment Strategy

The Commission proposes to apply Regulation Best Interest to recommendations of any securities transaction (sale, purchase, and exchange) [153] and investment strategy (including explicit recommendations to hold a security or regarding the manner in which it is to be purchased or sold) to retail customers.[154] Securities transactions may also include recommendations to roll over or transfer assets from one type of account to another, such as recommendations to roll over or transfer assets in an ERISA account to an IRA.[155]

We are not proposing at this time that the duty extend to recommendations of account types generally, unless the recommendation is tied to a securities transaction (*e.g.,* to roll over or transfer assets such as IRA rollovers). Evaluating the appropriateness of an account is an issue that implicates both broker-dealers and investment advisers that are making recommendations of a brokerage account or an advisory account. Accordingly, we are requesting comment below about the obligations that apply to both broker-dealers and investment advisers relating to recommendations of accounts generally, and whether and how we should address those obligations.

4. Retail Customer

The Commission proposes to define ''retail customer'' as: ''a person, or the legal representative of such person, who: (1) 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 (2) uses the recommendation primarily for personal, family, or household purposes.'' [156] The definition generally tracks the definition of ''retail customer'' under Section 913(a) of the Dodd-Frank Act, except as discussed below.

The Commission preliminarily believes this proposed definition is appropriate, and in particular, the limitation to recommendations that are ''primarily for personal, family or household purposes,'' as we believe it excludes recommendations that are related to business or commercial purposes, but remains sufficiently broad and flexible to capture recommendations related to the various reasons retail customers may invest (including, for example, for retirement, education, and other savings purposes). As discussed in more detail above, the Commission and studies have historically been, and continue to be, focused on the potential investor harm that conflicted advice can have on investors investing for present and future financial goals.[157] The

[147] *See supra* Section I.B (discussing a broker-dealer's existing obligations, including fiduciary obligations).

[148] BIC Exemption Release, 81 FR at 21032. *See also* DOL Fiduciary Rule Release, 81 FR at 20987 (''[T]he final rule does not impose on the person an automatic fiduciary obligation to continue to monitor the investment or the advice recipient's activities to ensure the recommendations remain prudent and appropriate for the plan or IRA. Instead, the obligation to monitor the investment on an ongoing basis would be a function of the reasonable expectations, understandings, arrangements, or agreements of the parties'').

[149] *Id.*

[150] *Id.* at 21032.

[151] *Id.*

[152] *Id.*

[153] This approach is consistent with existing broker-dealer suitability obligations. Regulation Best Interest applies only to recommendations, and not to the execution of a recommended transaction, which as discussed below is addressed by existing broker-dealer best execution obligations. *See, e.g.,* FINRA Rule 5310 (Best Execution and Interpositioning). Regulation Best Interest is separate from and does not alter these obligations. *See generally infra* Section II.D.2, for discussion of a broker-dealer's best execution obligations.

[154] FINRA interprets what is an investment strategy broadly. Examples of investment strategies are recommendations to purchase the ''Dogs of the Dow,'' securities on margin, liquify home mortgages, or explicit recommendations to hold securities. *See* FINRA Regulatory Notice 12–25 at Q7. Similarly, under antifraud case law, a recommendation can also encompass the manner for purchasing or selling the security. A recommendation to purchase on margin, if unsuitable, may violate antifraud provisions of the Exchange Act in the absence of disclosure. *See Troyer* v. *Karcagi,* 476 F. Supp. 1142, 1152 (S.D.N.Y. 1979) (opening an unsuitable margin account, without disclosure of the unsuitability to the customer, renders a broker-dealer primarily liable under section 10(b) and Rule 10b-5 if it acts with scienter); *Steven E. Muth and Richard J. Rouse,* Exchange Act Release No. 52551, at *19, 58 SEC. 770, 797 (Oct. 3, 2005) (Commission opinion) (finding registered representative's recommendations of risky margin purchases to customers who had relatively modest financial profiles and conservative investment objectives, where he also misled customers regarding adverse impact of margin trading, were unsuitable). *See also William J. Murphy and Carl M. Birkelbach,* Exchange Act Release No. 69923, at *17 (July 2, 2013) (Commission opinion, sustaining FINRA findings) (''The large margin debit balance in Lowry's account exacerbated the unsuitability of Murphy's already risky trading.'').

[155] A recommendation concerning the type of retirement account in which a customer should hold his retirement investments typically involves a recommended securities transaction, and thus is subject to FINRA suitability obligations. For example, a firm may recommend that an investor sell his plan assets and roll over the cash proceeds into an IRA. Recommendations to sell securities in the plan or to purchase securities for a newly-opened IRA are subject to FINRA suitability obligations. *See* FINRA Regulatory Notice 13–45. As previously noted, recommendations of unsuitable transactions may also violate the antifraud provisions of Securities Act Section 17(a); Exchange Act Section 10(b) and Rule 10b–5 thereunder.

[156] We believe that, pursuant to existing regulations, broker-dealers would generally be required to obtain sufficient facts concerning a retail customer to determine an account's primary purpose for purposes of Regulation Best Interest. For example, FINRA members are required to use reasonable diligence, in regard to the opening and maintenance of every account, to know (and retain) the essential facts concerning every customer and concerning the authority of each person acting on behalf of such customer. *See* FINRA Rule 2090 (Know Your Customer). Additionally, FINRA members are required to ascertain the customer's investment profile under FINRA suitability obligations. *See* FINRA Rule 2111 (Suitability).

[157] *See, e.g.,* 913 Study (focusing on retail investors trying to manage their investments to meet their own and their families' financial goals);

Continued

Commission continues to believe the focus of Regulation Best Interest should remain on investors with these personal goals but we request comment below on whether the definition of ''retail customer'' should be expanded or harmonized with the proposed definition of ''retail investor'' in the Relationship Summary Proposal, as defined and described below.

As noted, this definition differs from the definition of ''retail customer'' under Section 913 in three relevant aspects. First, for the reasons discussed above,[158] the Commission proposes to substitute ''recommendation of any securities transaction or investment strategy involving securities'' for ''personalized investment advice about securities.''

Second, the Commission proposes to extend the Section 913 definition beyond natural persons to *any persons,* provided the recommendation is primarily for personal, family, or household purposes. This extension would cover non-natural persons that the Commission believes would benefit from the protections of Regulation Best Interest (such as trusts that represent the assets of a natural person).[159] As discussed in Section II.E below, in light of this expansion from ''natural person'' to any person, we are proposing a new, separate recordkeeping requirement, as, among other things, the similar existing recordkeeping requirements refer only to ''natural persons.''

Third, the proposed definition would only apply to a person who ''receives a recommendation . . . from a broker or dealer or a natural person who is an associated person of a broker or dealer,'' and does not include a person who receives a recommendation from an investment adviser acting as such. This definition is appropriate as Regulation Best Interest only applies in the context of a brokerage relationship with a brokerage customer, and in particular, when a broker-dealer is making such a recommendation in the capacity of a broker-dealer.[160] In other words, Regulation Best Interest would not apply to the relationship between an investment adviser and its advisory client (or any recommendations made by an investment adviser to an advisory client).[161] Accordingly, dual-registrants would be required to comply with Regulation Best Interest only when making a recommendation in their capacity as a broker-dealer.

Regulation Best Interest and its specific obligations, including the Disclosure Obligation, Care Obligation, and Conflicts Obligations, would not apply to advice provided by a dual-registrant when acting in the capacity of an investment adviser, even if the person to whom the recommendation is made also has a brokerage relationship with the dual-registrant or even if the dual-registrant executes the transaction. Similarly, when an investment adviser provides advice, the rule would not apply to an affiliated broker-dealer or to a third-party broker-dealer with which a natural associated person of the investment advisers is associated if such broker-dealer executes the transaction in the capacity of a broker or dealer. For example, in the case of a dual-registrant that provides advice with respect to an advisory account and subsequently executes the transaction, Regulation Best Interest would not apply to the advice and transaction because the firm acted in the capacity of a broker-dealer solely when executing the transaction and not when providing advice about a securities transaction. In this case, when the advice is provided in the capacity of an investment adviser, the firm would be required to comply with the obligations prescribed under an investment adviser's fiduciary duty, as described in more detail in the Fiduciary Duty Interpretive Release.

The Commission recognizes that making the determination of whether a dual-registrant is acting in the capacity of a broker-dealer or an investment adviser is not free from doubt, and this issue has existed for dual-registrants prior to the proposal of Regulation Best Interest. Generally, determining whether a recommendation made by a dual-registrant is in its capacity as broker-dealer requires a facts and circumstances analysis, with no one factor being determinative. When evaluating this issue, the Commission considers, among other factors, the type of account (advisory or brokerage), how the account is described, the type of compensation, and the extent to which the dual-registrant made clear the capacity in which it was acting to the customer or client. We also have held the view that a dual-registrant is an investment adviser solely with respect to those accounts for which it provides advice or receives compensation that subjects it to the Advisers Act.[162] This interpretation of the Advisers Act permits a dual-registrant to distinguish its brokerage customers from its advisory clients. We recognize that this determination can leave interpretive and other challenges for dual-registrants with clients that have both brokerage and advisory accounts with the dual-registrant. Our Disclosure Obligation is designed to help address some of these challenges as the Commission believes

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RAND Study; Siegel & Gale Study; CFA 2010 Survey. *See also* IAC Recommendation; Section I.A.

[158] *See supra* Section II.C.2.

[159] This differs from the approach taken under current FINRA suitability obligations, which as discussed below, provide an exemption to broker-dealers from the customer-specific suitability obligation with respect to ''institutional accounts,'' including very high net worth natural persons, if certain conditions are met. Under the Commission's proposal, to the extent that the recommendation is not primarily used for personal, family, or household purposes, ''institutional accounts,'' as defined in FINRA Rules, would fall outside the definition of retail customer and be excluded from Regulation Best Interest, and as a consequence recommendations to such accounts would be solely subject to FINRA's suitability rule.

Under the FINRA rules, a broker-dealer's suitability obligations are different for certain institutional customers than for non-institutional customers. A broker-dealer is exempt from its customer-specific suitability obligation for an institutional account, if the broker-dealer: (1) Has a reasonable basis to believe that the institutional customer is capable of evaluating the risks independently, both in general and with regard to particular transactions and investment strategies, and (2) the institutional customer affirmatively indicates that it is exercising independent judgment in evaluating the broker-dealer's recommendations. FINRA 2111(b).

[160] This approach will facilitate broker-dealers building upon their current compliance infrastructure and will enhance investor protections to retail customers seeking financial services. FINRA's suitability rule applies to a person who is not a broker-dealer who opens a brokerage account at a broker-dealer or who 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 custodial agent, or using another similar arrangement. *See* FINRA Regulatory Notice 12–55, Guidance on FINRA's Suitability Rule (Dec. 2012) at Q6(a). A broker-dealer customer relationship could also arise if the individual or entity has an informal business relationship related to brokerage services, as long as the individual or entity is not a broker-dealer. *See* FINRA Regulatory Notice 12–25 at Q6.

In some instances, a brokerage relationship with a brokerage customer can exist without a formal brokerage account (*e.g.,* as established by an agreement with the broker-dealer). For example, broker-dealers can assist retail customers in purchasing mutual funds or variable insurance products to be held with the mutual fund or variable insurance product issuer, by sending checks and applications directly to the fund or issuer (this is sometimes referred to as ''check and application,'' ''application-way,'' ''subscription-way'' or ''direct application'' business; we use the term ''check and application'' for simplicity) even if that retail investor does not have an account with the broker-dealer. The broker-dealer is typically listed as the broker-dealer of record on the retail customer's account application, and generally receives fees or commissions resulting from the retail customer's transactions in the account. *See, e.g.,* FINRA Notice to Members 04–72, Transfers of Mutual Funds and Variable Annuities (Oct. 2004). Regulation Best Interest would apply to recommendations of such transactions even in the absence of a formal account.

[161] In a concurrent release, we are proposing an interpretation that would reaffirm—and in some cases clarify—certain aspects of the fiduciary duty that an investment adviser owes to its clients. *See* Fiduciary Duty Interpretive Release.

[162] *See* Release 51523; 2007 Proposing Release.

it will help clarify the capacity in which a dual-registrant is acting.

By proposing Regulation Best Interest, we are not intending to change the analysis regarding whether an investor is a brokerage customer or an advisory client, as we believe this issue is outside the scope of this rulemaking.[163] However, we seek comment below on this historical approach and whether particular scenarios involving investors with brokerage and advisory accounts need further clarification.

The proposed definition of ''retail customer'' also differs from the definition of ''retail investor'' proposed in the Relationship Summary Proposal, which is a prospective or existing client or customer who is a natural person (an individual), regardless of the individual's net worth (thus including, *e.g.,* accredited investors, qualified clients or qualified purchasers).[164] The relationship summary contemplated in the Relationship Summary Proposal, as defined and described below in Section II.D.1., is intended for a broader range of investors, before or at the time they first engage the services of a broker-dealer, to provide important information for them to consider when choosing a firm and a financial professional.[165] The Commission does not believe it is inconsistent or inappropriate, but rather beneficial, to require firms to provide a relationship summary to all natural persons to facilitate their understanding of the account choices, regardless of whether the retail customers will receive recommendations primarily for personal, family, or household purposes. Regulation Best Interest and its intended focus, however, is more limited in scope, in order to cover recommendations to ''retail customers'' who have chosen to engage the services of a broker-dealer after receiving the Relationship Summary required by the Relationship Summary Proposal.[166]

Furthermore, consistent with the definition of ''retail customer'' in Section 913 of the Dodd-Frank Act, except as noted above, and the 913 Study recommendation, the Commission is proposing to limit the application of Regulation Best Interest to any person, or the legal representative of such person, receiving and using a recommendation primarily for personal, family, or household purposes, such as trusts that represent natural persons. Given that our proposed definition applies to ''any person'' and not ''natural persons'' as used in the Relationship Summary Proposal, we believe it is appropriate to limit the definition to persons who receive recommendations primarily for these specified purposes, consistent with the Commission's historical focus,[167] as we do not intend at this time for Regulation Best Interest to apply to all recommendations to any person. Without such a limitation, we are concerned that this rule would apply to recommendations that are primarily for business purposes (such as any recommendations to institutions), which is beyond the intended focus of Regulation Best Interest, as discussed above.

5. Request for Comment on Key Terms and Scope of Best Interest Obligation

The Commission requests comment generally on the key terms and scope of the best interest obligation.

- Do commenters agree with the general approach of the best interest obligation of building on existing requirements?
- Should retail customers be permitted to amend their contracts with broker-dealers to modify the terms of Regulation Best Interest?

The Commission also requests comment specifically on the proposed definition of ''natural person who is an associated person.''

- Do commenters agree that proposed Regulation Best Interest should apply to natural persons that are associated persons of a broker-dealer? Why or why not?
- Are there alternative definitions that the Commission should consider?
- Is the proposed rule's limitation of applicability to ''a natural person who is an associated person'' appropriate? Why or why not?
- Should the Commission broaden or limit the scope of individuals to whom Regulation Best Interest applies? For example, should it apply to small business entities such as a sole proprietorship? Why or why not?

The Commission also requests comment specifically on the scope of the term ''recommendation.''

- Should the Commission define the term ''recommendation''? If so, should we define ''recommendation'' as described above?
- Does the term ''recommendation'' capture all of the actions to which Regulation Best Interest should apply? Why or why not?
- Should the Commission limit the application of Regulation Best Interest to when a recommendation is made? Why or why not?
- Is sufficient clarity provided regarding what ''at the time the recommendation is made'' means? Should the Commission define this phrase? Why or why not?
- Should Regulation Best Interest also cover broker-dealers that only offer a limited range of products, or that are engaging in other activities, even when not making a ''recommendation'' as discussed above? Why or why not?
- Instead, should Regulation Best Interest apply when a broker-dealer is providing ''personalized investment advice''? Why or why not? If so, how should the Commission define ''personalized investment advice''? Should the Commission definition follow the 913 Study, which recommended that such a definition should *at a minimum* encompass the making of a ''recommendation,'' and should not include ''impersonal investment advice''?[168] What broker-dealer activities would be covered by using this definition that would not be currently covered by limiting the rule to a ''recommendation''?
- As noted above, the term ''recommendation'' has been interpreted in the context of Commission rules, the FINRA suitability requirement, and the DOL Fiduciary Rule. Should the Commission define or describe more fully what is a ''recommendation'' in this context? Should the Commission interpret the term ''recommendation'' differently than it has been interpreted by the Commission and FINRA to date? If so, what should the interpretation be and why? In what specific circumstances, if any, would additional guidance as to the meaning of ''recommendation'' be useful? Does the description of what would be a recommendation provide sufficient clarity in this regard? Why or why not?
- Has the Commission appropriately distinguished a recommendation from investor education? Why or why not? If not, what communications should be considered a recommendation or alternatively, investor education? How would these situations differ from the current standards with respect to what is a recommendation versus investor education?
- Regulation Best Interest would apply to both discretionary and non-discretionary recommendations made by a broker-dealer. Do commenters agree

[163] *Id.*

[164] The definition of ''retail investor'' would include a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust. *See* Relationship Summary Proposal, *supra* Section II.D.1.

[165] *See* Relationship Summary Proposal, *supra* note 8 and accompanying text.

[166] *Id.*

[167] *See supra* notes 157 and 166 and accompanying text.

[168] *See* 913 Study at 123–27.

that Regulation Best Interest should apply to any discretionary recommendation made by a broker-dealer?[169] Courts have found broker-dealers that exercise discretion or de facto control of an account to be fiduciaries under state law. What additional protections do brokerage customers receive, if any, when their broker-dealers are considered fiduciaries under state law? Does Regulation Best Interest adequately account for these additional protections?

The Commission requests comment on the scope of ''any securities transaction or investment strategy involving securities.''

- Do commenters agree that proposed Regulation Best Interest should apply to recommendations of ''any securities transaction or investment strategy involving securities''? Do commenters agree with our proposed interpretation of the scope of these terms? Why or why not?
- Do commenters have alternative suggestions on the types of recommendations to which Regulation Best Interest would apply? Please specifically identify any recommendations that should be covered by the proposed rule and explain why they should be covered.
- Are there other broker-dealer recommendations that are not captured by these terms that should be covered by Regulation Best Interest? Please specify any recommendations that would not be covered by the proposed rule and why they should or should not be covered.
- Should the Commission provide additional guidance as to what is or is not an ''investment strategy involving securities''? Please identify where further guidance is needed and why recommendations should or should not be viewed as an ''investment strategy involving securities.''
- Should the Commission extend Regulation Best Interest to recommendations of account types even if the recommendation is not tied to a securities transaction? If so, what factors should a broker-dealer consider in making a recommendation of an account type? Should the factors differ if the account type recommended is discretionary versus non-discretionary? Should they differ for dual-registrants versus standalone broker-dealers?
- Should the rule include an obligation to perform ongoing or periodic evaluation of whether an account type initially recommended remains appropriate? If so, how frequently and what factors should that evaluation take into consideration?
- What factors do firms consider in determining the appropriateness of an account for a particular investor, if any, and what weight is given to the factors considered (*i.e.,* do certain factors carry more weight than others)?
- What policies and procedures do firms currently use, if any, to supervise recommendations by their associated persons of account types?
- How do firms mitigate incentives for associated persons to recommend inappropriate account types?

The Commission requests comment on the definition of ''retail customer.''

- Do commenters agree with the proposed definition of ''retail customer''? Why or why not? Should the definition be narrowed or expanded in any way? For example, should it apply to small business entities such as a sole proprietorship? Why or why not?
- Are there are other definitions of ''retail customer'' that the Commission should consider? If so, please provide any alternative definition and the reasons why it is being suggested. For example, should the Commission instead use the definition of ''retail investor'' that is being proposed in the Relationship Summary or that is used in the 913 Study?
- Regulation Best Interest would apply to recommendations to retail customers, while FINRA's general suitability requirements apply to recommendations to all customers (although a broker-dealer is exempt from its customer-specific suitability obligation for an institutional account, if certain conditions are met).[170] Do commenters agree that having differing standards of care for different broker-dealer customers is appropriate? Why or why not? Would differing standards for different customers of broker-dealers confuse retail or other customers? Would differing standards for different customers make it more difficult for broker-dealers to comply with their obligations?
- Do commenters believe that the definition of ''retail customer'' should instead only include all natural persons as under Section 913? Why or why not?
- Do commenters believe the limitation of the proposed definition of ''retail customer'' to recommendations primarily for ''personal, family or household purposes'' is appropriate and clear? Why or why not? As proposed, the definition of ''retail customer,'' including the limitation, would cover, for example, participants in ERISA-covered plans and IRAs. Should participants in these types of plans be covered? Why or why not? Do firms require more guidance regarding the current application of the law to specific scenarios? Should the limitation be omitted? Why or why not?
- The Commission requests comment on the proposed approach with respect to dual-registrants. How do firms currently make the determination of what capacity a dual-registrant is acting in when making a recommendation or otherwise? Do commenters require more guidance regarding the current application of the law to specific scenarios? Do commenters agree with the Commission's interpretations of when a dual-registrant is acting as an investment adviser? Why or why not? Do commenters agree with the Commission's interpretations of when a dual-registrant is acting as a broker-dealer? Why or why not?

D. Components of Regulation Best Interest

As part of Regulation Best Interest, we are proposing specifying that the obligation to ''act in the best interest of the retail customer . . . . without placing the financial or other interest of the [broker-dealer] ahead of the retail customer'' shall be satisfied if the broker-dealer complies with four component requirements: A Disclosure Obligation, a Care Obligation, and two Conflict of Interest Obligations. Each of these components is discussed below. Failure to comply with any of these requirements when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer would violate Regulation Best Interest.

In specifying by rule these obligations, we intend to provide clarity to broker-dealers on the requirements of the best interest obligation. To that end, the best interest obligation does not impose any obligations other than those specified by the rule: Namely, to act in the best interest of the retail customer without placing the financial or other interest of the broker-dealer ahead of the retail customer's interest, by complying with each of the components as set forth in paragraph (a)(2) of the rule.

We wish to reemphasize that we recognize that components of these obligations draw from obligations that have been interpreted under the antifraud provisions of the federal securities laws, or may be specifically addressed by the Exchange Act or the rules thereunder or SRO rules. In proposing these obligations, we are not

[169] *See also infra* Section II.F. for a discussion and request for comment regarding broker-dealer exercise of discretion and the extent to which such exercise is ''solely incidental'' to the conduct of its business as a broker-dealer.

[170] FINRA Rule 2111(b).

proposing to amend or eliminate existing broker-dealer obligations, and compliance with Regulation Best Interest is not determinative of a broker-dealer's compliance with obligations under the general antifraud provisions of the federal securities laws.[171]

1. Disclosure Obligation

The Commission is proposing the Disclosure Obligation, which would require a broker-dealer, or natural person who is an associated person of a broker or dealer ''to, prior to or at the time of such recommendation, reasonably disclose to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer and all material conflicts of interest associated with the recommendation.'' We believe that an important aspect of the broker-dealer's best interest obligation is to facilitate its retail customers' awareness of certain key information regarding their relationship with the broker-dealer.[172] Specifically, and as discussed more below, to meet the Disclosure Obligation, we would consider the following to be examples of material facts relating to the scope and terms of the relationship with the retail customer: (i) That the broker-dealer is acting in a broker-dealer capacity with respect to the recommendation; (ii) fees and charges that apply to the retail customer's transactions, holdings, and accounts; and (iii) type and scope of services provided by the broker-dealer, including, for example, monitoring the performance of the retail customer's account. While these examples are indicative of what the Commission believes would generally be material facts regarding the scope and terms of the relationship, brokers, dealers, and natural persons who are associated persons of a broker or dealer would need to determine what other material facts relate to the scope and terms of the relationship, and reasonably disclose them in writing prior to or at the time of a recommendation. Additionally, this Disclosure Obligation would explicitly require the broker-dealer to, prior to or at the time of such recommendation, reasonably disclose in writing all material conflicts of interest[173] associated with the recommendation.

We understand that broker-dealers typically provide information about their services and accounts, which may include disclosure concerning the broker-dealer's capacity, fees, services, and conflicts,[174] on their firm websites and in their account opening agreements. While broker-dealers are subject to a number of specific disclosure obligations when they effect certain customer transactions,[175] and are subject to additional disclosure obligations under the antifraud provisions of the federal securities laws,[176] broker-dealers are not currently subject to an explicit and broad disclosure requirement under the Exchange Act.[177] To promote broker-

[171] Any transaction or series of transactions, whether or not effected pursuant to the provisions of Regulation Best Interest, remain subject to the antifraud and anti-manipulation provisions of the securities laws, including, without limitation, Section 17(a) of the Securities Act [15 U.S.C. 77q(a)] and Sections 9, 10(b), and 15(c) of the Exchange Act [15 U.S.C. 78i, 78j(b), and 78o(c)].

[172] Several commenters maintained that a disclosure requirement with such information would be an effective approach to addressing consumer confusion. *See, e.g.,* State Farm 2017 Letter (recommending a simplified account opening disclosure that includes: (1) The type of relationship being entered into and specific duties owed to the consumer based on the services performed; (2) the services available as part of the relationship, and information about applicable direct and indirect investment-related fees; and (3) information about material conflicts of interest that apply to these relationships, including material conflicts arising from compensation arrangements or proprietary products); Letter from Paul S. Stevens, President and CEO, Investment Company Institute (Feb. 5, 2018) (''ICI February 2018 Letter'') (recommending a best interest standard requiring broker-dealers to disclose to retail customers certain aspects of their relationship with the retail customer, ''such as the type and scope of services provided, the applicable standard of conduct, the types of compensation it or its associated persons receive, and any material conflicts of interest''); Letter from Michelle B. Oroschakoff, LPL Financial, (Feb. 22, 2018) (''LPL Financial'') (recommending a standard of conduct that requires clear and comprehensive disclosure to retail investors explaining material information about their services, including the nature of the services, investment products, compensation, and material conflicts of interest).

[173] Under Regulation Best Interest, as proposed, a broker-dealer's obligation to disclose material conflicts of interest would resemble the duty to disclose material conflicts that has been imposed on broker-dealers found to be acting in a fiduciary capacity. *See, e.g., United States* v. *Szur,* 289 F.3d 200, 212 (2d Cir. 2002) (broker's fiduciary relationship with customer gave rise to a duty to disclose commissions to customer, which would have been relevant to customer's decision to purchase stock); *Arleen W. Hughes,* Exchange Act Release No. 4048 (Feb. 18, 1948) (Commission Opinion), *aff'd sub nom. Hughes* v. *Sec. & Exch. Comm'n,* 174 F.2d 969, 976 (D.C. Cir. 1949) (broker acted in the capacity of a fiduciary and, as such, broker was under a duty to make full disclosure of the nature and extent of her adverse interest, ''including her cost of the securities and the best price at which the security might be purchased in the open market'').

[174] The 913 Study noted that, in practice, required disclosures of conflicts have been more limited with broker-dealers than with investment advisers. *See* 913 Study at 106. In addition, the Tully Report focused on the potential harm to investors due to broker-dealer conflicts of interest and in particular those related to compensation. As a best practice, the Tully Report suggested increased disclosure. *See also* Tully Report at 16 (finding that full disclosure of the broker-dealer compensation practices could reduce the ''potential for conflict and abuse); discussion *supra* Section I.A.

[175] *See, e.g.,* Exchange Act Rule 10b–10, which generally requires a broker-dealer effecting customer transactions in securities (other than U.S. savings bonds or municipal securities) to provide written notification to the customer, at or before completion of the transaction, disclosing information specific to the transaction, including whether the broker-dealer is acting as agent or principal and its compensation, as well as any third-party remuneration it has received or will receive. 17 CFR 240.10b–10. *See also* Exchange Act Rules 15c1–5 and 15c1–6, which require a broker-dealer to disclose in writing to the customer if it has any control, affiliation, or interest in a security it is offering or the issuer of such security. 17 CFR 240.15c1–5 and 15c1–6. There are also specific, additional obligations that apply, for example, to recommendations by research analysts in research reports and to public appearances under Regulation Analyst Certification (AC). *See, e.g.,* 17 CFR 242.500 *et seq.* Finally, SRO rules apply to specific situations, such as FINRA Rule 2124 (Net Transactions with Customers); FINRA Rule 2262 (Disclosure of Control Relationship with Issuer), and FINRA Rule 2269 (Disclosure of Participation or Interest in Primary or Secondary Distribution).

[176] *See, e.g., supra* note 87. Broker-dealers are liable under the antifraud provisions for failure to disclose material information to their customers when they have a duty to make such disclosure. *See Basic* v. *Levinson,* 485 U.S. 224, 239 n.17 (1988) (''Silence, absent a duty to disclose, is not misleading under Rule 10b–5.''); *Chiarella* v. *U.S.,* 445 U.S. 222, 228 (1980) (explaining that a failure to disclose material information is only fraudulent if there is a duty to make such disclosure arising out of ''a fiduciary or other similar relation of trust and confidence''); *SEC* v. *Monarch Funding Corp.,* 192 F.3d 295, 308 (2d Cir. 1999) (explaining that defendant is liable under Section 10(b) and Rule 10b–5 for material omissions ''as to which he had a duty to speak'').

Generally, under the antifraud provisions, a broker-dealer's duty to disclose material information to its customer is based upon the scope of the relationship with the customer, which is fact intensive. *See, e.g., Conway* v. *Icahn & Co., Inc.,* 16 F.3d 504, 510 (2d Cir. 1994) (''A broker, as agent, has a duty to use reasonable efforts to give its principal information relevant to the affairs that have been entrusted to it.'').

For example, where a broker-dealer processes its customers' orders, but does not recommend securities or solicit customers, then the material information that the broker-dealer is required to disclose is generally narrow, encompassing only the information related to the consummation of the transaction. *See, e.g., Press* v. *Chemical Inv. Servs. Corp.,* 166 F.3d 529, 536 (2d Cir. 1999). However, courts and the Commission have found that a broker-dealer's duty to disclose material information under the antifraud provisions is broader when the broker-dealer is making a recommendation to its customer. *See, e.g., Hanly,* 415 F.2d 589, 597 (2d Cir. 1969). When recommending a security, broker-dealers generally are liable under the antifraud provisions if they do not give ''honest and complete information'' or disclose any material adverse facts or material conflicts of interest, including any economic self-interest. *See, e.g., De Kwiatkowski* v. *Bear, Stearns & Co.,* 306 F.3d 1293, 1302 (2d Cir. 2002); *Chasins* v. *Smith, Barney & Co.,* 438 F.2d 1167, 1172 (2d Cir. 1970).

[177] Broker-dealers may be subject to additional disclosure requirements imposed by other regulators. For example, as noted, the BIC Exemption and related PTEs impose detailed disclosure conditions on broker-dealers that rely on those exemptions. Other DOL regulations and exemptions also impose disclosure requirements applicable to broker-dealers providing advisory and other services to ERISA-covered plans and IRAs. *See, e.g.,* 29 CFR 2550.408g–1(b)(7)(G) (regulation

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dealer recommendations that are in the best interest of retail customers, we believe it is necessary to impose a more explicit disclosure obligation on broker-dealers than what currently exists under the federal securities laws and SRO rules.

This Disclosure Obligation also forms an important part of a broader effort to address retail investor confusion, as further discussed in a separate concurrent rulemaking.[178] Studies have shown that retail investors are confused about the differences among financial service providers, such as broker-dealers, investment advisers, and dual-registrants.[179] We have carefully considered these concerns regarding investor confusion, and are committed to facilitating greater clarity for retail investors. In our concurrent rulemaking, we propose to: [180] (1) Require broker-dealers and investment advisers to provide to retail investors [181] a short (*i.e.,* four page or equivalent limit if in electronic format) relationship summary (''Relationship Summary''); [182] (2) restrict broker-dealers and associated natural persons of broker-dealers, when communicating with a retail investor, from using the term ''adviser'' or ''advisor'' in specified circumstances; and (3) require broker-dealers and investment advisers, and their associated natural persons and supervised persons, respectively, to disclose, in retail investor communications, the firm's registration status with the Commission and an associated natural person's and/or supervised person's relationship with the firm (''Regulatory Status Disclosure'').[183]

These proposed obligations reflect common goals and touch on issues that are also contemplated under the proposed Disclosure Obligation under Regulation Best Interest, notably clarifying the capacity in which a firm or financial professional is acting, minimizing investor confusion, and facilitating greater awareness of key aspects of a relationship with a firm or financial professional, such as the applicable standard of conduct, fees, and material conflicts of interest. We believe these obligations complement each other and, consistent with our layered approach to disclosure, are designed to build upon each other to provide different levels of key information that we preliminarily believe are appropriate at different points of the relationship with a broker-dealer.

The Relationship Summary highlights certain features of an investment advisory or brokerage relationship, which is designed to alert retail investors to information for them to consider when choosing a firm and a financial professional. This would be achieved by requiring that the Relationship Summary be initially delivered to a retail investor before or at the time a retail investor enters into an investment advisory agreement or first engages a brokerage firm's services.[184]

By virtue of the high level nature of the disclosures in the Relationship Summary, constituting a mix of prescribed language and more firm-specific disclosures, and the space constraints (no more than four pages or equivalent limit if in electronic format), the Relationship Summary would form just one part of a broker-dealer's broader set of disclosures. Firms would include information retail investors need to understand the services, fees, conflicts, and disciplinary history of firms and financial professionals they are considering, along with references and links to other disclosure where interested investors can find more detailed information. In this way, the Relationship Summary is intended to foster a layered approach to disclosure, as described above. It is also designed to facilitate comparisons across firms that offer the same or substantially similar services.[185]

The Disclosure Obligation under Regulation Best Interest further builds on and complements these obligations as it would require a broker-dealer or natural person who is an associated person of a broker-dealer to, prior to or at the time of the recommendation, reasonably disclose, in writing, the material facts relating to the scope and terms of the relationship with the retail customer and all material conflicts of interest associated with the recommendation. The Disclosure Obligation under Regulation Best Interest would apply specifically to the broker-dealer or natural person who is an associated person of the broker-dealer and the specific recommendation triggering Regulation Best Interest.

For example, whereas the Relationship Summary would require a brief and general description of the types of fees and expenses that retail investors will pay, under the Disclosure Obligation we would generally expect broker-dealers to build upon the Relationship Summary to provide more specific fee disclosures relevant to the recommendation to the retail customer and the particular brokerage account for which recommendations are made. In addition, while the Relationship Summary would require a high-level description of specified conflicts of interest, the Disclosure Obligation would require more comprehensive disclosure of all material conflicts of interest related to the recommendation to the retail customer.

Thus, as a general matter, the Regulatory Status Disclosure and the Relationship Summary reflect initial layers of disclosure, with the Disclosure Obligation reflecting more specific and additional, detailed layers of disclosure.[186]

a. Disclosure of Material Facts Relating to the Scope and Terms of the Relationship

As noted above, to meet this Disclosure Obligation, we would generally consider the following to be examples of material facts relating to the scope and terms of the relationship with the retail customer: (i) That the broker-dealer is acting in a broker-dealer capacity with respect to the recommendation; (ii) fees and charges that apply to the retail customer's transactions, holdings, and accounts; and (iii) type and scope of services provided by the broker-dealer, including, for example, monitoring the performance of the retail customer's account. This Disclosure Obligation

under statutory exemption for participant advice requires fiduciary advisers to plans and IRAs seeking relief to deliver certain disclosures and acknowledge fiduciary status); 29 CFR 2550.408b–2(c)(iv)(B) (regulation under statutory exemption for reasonable service arrangements requires certain ERISA plan service providers to disclose certain information in writing including (among other things) a description of the services to be provided, the fees to be paid directly and indirectly by the plan and, if applicable, a statement that the service provider will provide or reasonably expects to provide services as a ''fiduciary'' as defined by ERISA).

[178] *See* Relationship Summary Proposal.

[179] *See, e.g.,* Siegel & Gale Study; RAND Study. *See also* CFA 2010 Survey.

[180] *See* Relationship Summary Proposal.

[181] As described in more detail under the definition of ''retail customer'' in Section II.C.4, the definition used in this proposed rulemaking differs from the definition of ''retail investor'' used in the Relationship Summary Proposal.

[182] The customer or client relationship summary is being proposed as ''Form CRS.''

[183] *See* Relationship Summary Proposal.

[184] We note that the Relationship Summary may be provided *after* the retail investor has initially decided to meet with the firm or its financial professional, a selection which may have been based on such person's name or title. This highlights the importance of facilitating clarity and accuracy in the use of names and titles, as is intended by the proposed restrictions on titles and the Regulatory Status Disclosure. *See* Relationship Summary Proposal.

[185] For further discussion, *see* Relationship Summary Proposal.

[186] Nevertheless, as discussed below where relevant, in some instances, disclosures made pursuant to the Regulatory Status Disclosure or the Relationship Summary may be sufficient to satisfy some aspects of this Disclosure Obligation.

would also require broker-dealers and natural persons who are associated persons of the broker-dealer to determine, 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 would need to be disclosed. For example, this would include considering whether it is necessary, and if so how, to build upon the high-level summary disclosures pursuant to the Relationship Summary.

(1) Capacity

We have identified the capacity in which a broker-dealer is acting as a likely material fact relating to the scope and terms of the relationship that would be subject to the Disclosure Obligation. In doing so, we hope to achieve greater awareness among retail customers of the capacity in which their financial professional or firm acts when it makes recommendations [187] so that the retail customer can more easily identify and understand the relationship, scope of services, and standard of conduct that applies to such recommendations. As noted above, the broker-dealer's standard of conduct would be disclosed in plain language in the Relationship Summary.

For a broker-dealer that is not a dual-registrant (a ''standalone broker-dealer''), or a natural person that is an associated person of a standalone broker-dealer (and that natural person is not also a supervised person of a registered investment adviser), the broker-dealer or associated person would disclose that it is acting in a broker-dealer capacity by complying with the Relationship Summary and the Regulatory Status Disclosure requirements of the Relationship Summary Proposal, described above. Because the Disclosure Obligation would require disclosure ''prior to, or at the time of'' the recommendation, the broker-dealer generally would not be expected to repeat the disclosure each time it makes a recommendation. Rather, we would consider the broker-dealer to have reasonably disclosed the capacity in which it is acting at the time of the recommendation, if the broker-dealer had already—''prior to . . . the time of'' the recommendation—delivered the Relationship Summary to the retail customer in accordance with the requirements of proposed Exchange Act Rule 17a–14 and had complied with the Regulatory Status Disclosure. We believe that delivery of the Relationship Summary would clearly articulate to the retail customer that he/she has a relationship with a broker-dealer, and that the broker-dealer must act in his/her best interest when providing advice in the form of a recommendation in the capacity of a broker or dealer, in addition to other specified information concerning the broker-dealer. Moreover, the Regulatory Status Disclosure would help ensure that each written or electronic investor communication clearly alerts the retail customer to the capacity in which the firm or financial professional acts.

Retail customers of dual-registrants or of financial professionals who are dually-registered may be more susceptible to confusion regarding the capacity in which their firms or financial professionals are acting with respect to any particular recommendation. For that reason, delivery of the Relationship Summary and compliance with the Regulatory Status Disclosure would not be considered reasonable disclosure of the capacity in which a dually-registered broker-dealer or dually-registered individual is acting at the time of the recommendation. Pursuant to the Relationship Summary Proposal, a dual-registrant would deliver to the retail customer a Relationship Summary that describes both the brokerage and advisory services offered by the firm, and as such, would not provide clarity regarding the capacity in which the dual-registrant is acting in the context of any particular recommendation. Similarly, the Regulatory Status Disclosure would require disclosure of both capacities in which firms and financial professionals act. Therefore, the Commission would expect a broker-dealer that is a dual-registrant to do more to meet the Disclosure Obligation.

As discussed below in our guidance on reasonable disclosure, we are not proposing to mandate the form, specific timing, or method for delivering disclosure pursuant to the Disclosure Obligation, other than the general requirement that the disclosure be made ''prior to or at the time of'' the recommendation. Instead, we aim to provide broker-dealers flexibility in determining how to satisfy the Disclosure Obligation. As part of that determination, the dual-registrant should consider how best to assist its retail customers in understanding the capacity in which it is acting. For example, dual-registrants could disclose capacity through a variety of means, including, among others, written disclosure at the beginning of a relationship (*e.g.,* in an account opening agreement or account disclosure) that clearly sets forth when the broker-dealer would act in a broker-dealer capacity and how it will provide notification of any changes in capacity (*e.g.,* ''All recommendations will be made in a broker-dealer capacity unless otherwise expressly stated at the time of the recommendation.'' or ''All recommendations regarding your brokerage account will be made in a broker-dealer capacity, and all recommendations regarding your advisory account will be in an advisory capacity. When we make a recommendation to you, we will expressly tell you which account we are discussing and the capacity in which we are acting.''). So long as the broker-dealer provides this type of disclosure *in writing* prior to the recommendation, we preliminarily believe that the broker-dealer would not need to provide written disclosure each time it changes capacity or each time it makes a recommendation, provided it makes clear the capacity in which the broker-dealer is acting in accordance with its initial disclosure.[188]

(2) Fees and Charges

A broker-dealer's fees and charges that apply to retail customers' transactions, holdings, and accounts would also be examples of items we would generally consider to be ''material facts relating to the scope and terms of the relationship.'' As such, fees and charges would generally fall under the requirement for written disclosure prior to, or at the time of, the recommendation. Fees and charges are important to retail investors,[189] but many retail investors are uncertain about the fees they will pay.[190] Many commenters have stressed the importance of clear fee disclosure to retail investors.[191]

[187] *See supra* Section II.B.

[188] *See infra* note 216 and accompanying text.

[189] *See* Staff of the Securities and Exchange Commission, Study Regarding Financial Literacy Among Investors as required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Aug. 2012), at iv (''With respect to financial intermediaries, investors consider information about fees, disciplinary history, investment strategy, conflicts of interest to be absolutely essential.''), *available at https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf.*

[190] *See* Rand Study, *supra* note 28, at xix (''In fact, focus-group participants with investments acknowledged uncertainty about the fees they pay for their investments, and survey responses also indicate confusion about the fees.'').

[191] *See, e.g.,* Wells Fargo 2017 Letter (recommending disclosure of fees and the scope of activities, among other information, as part of a recommended standard of conduct); ACLI Letter (recommending, among other things, full and fair disclosure of the recommended product's features, fees, and charges, and fairly disclosing how and by whom the financial professional is compensated); SIFMA 2017 Letter (recommending a new broker-dealer standard of conduct being accompanied by

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As described more fully in the Relationship Summary Proposal, the Relationship Summary is designed to provide investors greater clarity concerning the principal fees and charges they should expect to pay and how the types of fees and charges affect the incentives of the firm and their financial professionals.[192] However, the proposed Relationship Summary would focus on general descriptions regarding types of fees and charges, rather than offer a comprehensive or personalized schedule of fees or other information about the amounts, percentages or ranges of fees and charges. Although we are not proposing to mandate the form, specific content or method for delivering fee disclosure, in furtherance of the goal of layered disclosure, to meet the Disclosure Obligation, we would generally expect broker-dealers to build upon the Relationship Summary, by disclosing additional detail (including quantitative information, such as amounts, percentages or ranges) regarding the types of fees and charges described in the Relationship Summary.[193]

(3) Type and Scope of Services

The type and scope of services a broker-dealer provides its retail customers would also be an example of what typically would be ''material facts relating to the scope and terms of the relationship,'' and thus would likely need to be disclosed prior to, or at the time of the recommendation, pursuant to this obligation. More specifically, we believe broker-dealers should, consistent with the goal of layered disclosure, build upon their disclosure in the Relationship Summary, and provide additional information regarding the types of services that will be provided as part of the relationship with the retail customer and the scope of those services.

In particular, in the Relationship Summary, broker-dealers would provide high level disclosures concerning services offered to retail investors, including, for example, recommendations of securities, assistance with developing or executing an investment strategy, monitoring the performance of the retail investor's account, regular communications, and limitations on selections of investments.[194] A broker-dealer that offers different account types, or that offers varying additional services to retail customers may not be able, within the content and space constraints of the Relationship Summary, to provide the ''material facts relating to the scope and terms of the relationship'' with the retail customer (which may include further detail regarding the specific products and services offered in that retail customer's account,[195] any limitations on those products or services, the frequency and duration of those services, and the standards of conduct that apply to those services). Pursuant to the Disclosure Obligation, we would generally expect broker-dealers to disclose these types of material facts concerning the actual services offered as part of the relationship with the retail customer (*i.e.,* specific to the type of account held by the retail customer) in a separate document or documents.[196]

b. Material Conflicts of Interest

The Disclosure Obligation would also explicitly require the broker-dealer to, prior to or at the time of such recommendation, reasonably disclose all material conflicts of interest associated with the recommendation. For purposes of Regulation Best Interest, we propose to interpret a ''material conflict of interest'' as a conflict of interest that a reasonable person would expect might incline a broker-dealer—consciously or unconsciously—to make a recommendation that is not disinterested. In determining how to interpret what constitutes a ''material conflict of interest,'' we considered the definition of ''material conflict of interest'' as used in BIC Exemption and related PTEs.[197] However, we developed this proposed interpretation based on the Advisers Act as we believe it is appropriate to interpret the term in accordance with existing and well-established Commission precedent regarding identification of conflicts of interest for which advisers may face antifraud liability under the Advisers Act in the absence of full and fair disclosure.[198]

We believe that this obligation to disclose should only apply to ''*material* conflicts of interest,'' and not to ''*any* conflicts of interest'' that a broker-dealer may have with the retail customer. Limiting the obligation to ''material'' conflicts is consistent with case law under the antifraud provisions, which limit disclosure obligations to ''*material* facts,'' even when a broker-dealer is in

enhanced up-front disclosure, including information such as the type and scope of services, and the types of compensation the broker-dealer may receive and the customer may pay); UBS 2017 Letter (recommending, in the context of variable compensation received based on a recommendation, an exemption subject to meeting the new standards of conduct and providing a disclosure document (similar to Form ADV) that would include compensation that may be received from clients and from third parties, material conflicts of interest, and the types of compensation for the various products and services available); ICI August 2017 Letter (recommending a best interest standard including, among other provisions, a requirement to disclose certain key aspects of a broker-dealer's relationship with the customer, such as the type and scope of services provided, the applicable standard of conduct, and the types of compensation it or its associated persons receive); State Farm 2017 Letter (recommending a standardized, plain-English disclosure requirement as a part of a standard of conduct, which would include, among other information, the services available and applicable fees); Bernardi Letter (recommending a ''standardized, straightforward, and truthful disclosure regime'' describing, among other things, all fees and commissions earned (including direct/indirect fees, and pricing discounts received)); Vanguard Letter (recommending a standard including several components such as enhanced disclosure, which would include the nature and scope of the duty owed to clients and the types of direct and indirect compensation to be received, among other things).

[192] As discussed above, broker-dealers are also currently subject to a number of specific disclosure obligations when they effect certain customer transactions, and additional disclosure obligations under the antifraud provisions of the federal securities laws. *See supra* notes 175, 176, 177 and accompanying text. *See also* Exchange Act Rules 15g–4 and 15g–5 (prior to effecting a penny stock transaction, a broker-dealer generally is required to provide certain disclosures, including the aggregate amount of any compensation received by the broker-dealer in connection with such transaction; and the aggregate amount of cash compensation that any associated person of the broker-dealer has received or will receive from any source in connection with the transaction). Additional fee disclosure requirements are also addressed in SRO guidance. *See, e.g.,* FINRA Regulatory Notice 13–23, Brokerage and Individual Retirement Account Fees (July 2013) (providing guidance on disclosure of fees in communications concerning retail brokerage accounts and IRAs).

[193] Specifically, the Relationship Summary requires high level disclosures (in part, through prescribed statements) concerning broad categories, but not specific amounts, percentages or ranges of transaction-based or other fees (including commissions, mark-ups and mark-downs and sales ''loads''), other account fees and expenses (including, for example, custodian, account maintenance and account inactivity fees), and investment fees and expenses for certain products such as mutual funds and variable annuities.

[194] *See* Relationship Summary Proposal.

[195] Broker-dealers may determine that other services, not included as part of the Relationship Summary, are also ''material facts relating to the scope and terms of the relationship,'' including, for example, margin, cash management, discretionary authority (consistent with the discussion in Section II.F), access to research, etc.

[196] As noted above, we understand that broker-dealers already typically provide some of these disclosures through various means. *See supra* notes 175, 176, 177 and accompanying text.

[197] In the BIC Exemption, a Material Conflict of Interest exists when an Adviser or Financial Institution has a ''financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor.'' *See* BIC Exemption.

[198] *See SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 191–92, 194 (1963), (stating that as part of its fiduciary duty, an adviser must ''fully and fairly'' disclose to its clients all material information in accordance with Congress's intent ''to eliminate, or at least expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested'').

a relationship of trust and confidence with its customer.[199] Limiting disclosure to material conflicts is designed to provide retail customers with full disclosure of key pieces of information regarding those conflicts that may affect a recommendation to a retail customer.[200] We believe that expanding the scope of the obligation more broadly to cover *any* conflicts a broker-dealer may have would inappropriately require broker-dealers to provide information regarding conflicts that would not ultimately affect a retail customer's decision about a recommended transaction or strategy and might obscure the more important disclosures.

The Disclosure Obligation applies to any ''material conflict of interest,'' including those arising from financial incentives. As discussed below, the proposed Conflict of Interest Obligations would require a broker-dealer to establish, maintain and enforce written policies and procedures reasonably designed to: (1) Identify and at a minimum disclose, or eliminate, all material conflicts of interest associated with the recommendation; and (2) identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with the recommendation. To the extent a broker-dealer determines, pursuant to the Conflict of Interest Obligations, not to eliminate, but to disclose a material conflict of interest, or to disclose and mitigate a material conflict of interest that is a financial incentive, this Disclosure Obligation would apply.

We preliminarily believe that a material conflict of interest that generally should be disclosed would include material conflicts associated with recommending: Proprietary products,[201] products of affiliates, or limited range of products;[202] one share class versus another share class of a mutual fund[203]; securities underwritten by the firm or a broker-dealer affiliate; the rollover or transfer of assets from one type of account to another (such as recommendations to rollover or transfer assets in an ERISA account to an IRA, when the recommendation involves a securities transaction)[204]; and allocation of investment opportunities among retail customers (*e.g.,* IPO allocation). A broker-dealer should also consider whether these conflicts arise from financial incentives that need to be mitigated, as discussed in proposed paragraph (a)(2)(iv).

For the avoidance of doubt, the requirement under Regulation Best Interest that a broker-dealer disclose information about material conflicts of interest is not intended to limit or restrict a broker-dealer's obligations under federal securities laws, including the general antifraud provisions of the federal securities laws, relating to disclosure of additional information to a customer at the time of the customer's investment decision.[205]

c. Guidance on Reasonable Disclosure

We are proposing that the Disclosure Obligation would require a broker-dealer, or natural person who is an associated person of a broker or dealer to ''reasonably'' disclose material facts, including material conflicts. In lieu of setting explicit requirements by rule for what constitutes effective disclosure, the Commission proposes to provide broker-dealers with flexibility in determining the most appropriate way to meet this Disclosure Obligation depending on each broker-dealer's business practices, consistent with the principles set forth below and in line with the suggestion of some commenters that stressed the importance of allowing broker-dealers to select the form and manner of delivery of disclosure.[206] To facilitate compliance with this Disclosure Obligation, the Commission is providing preliminary guidance, as discussed below, on what it believes would be to ''reasonably'' disclose in accordance with the Disclosure Obligation by setting forth the aspects of effective disclosure, including the form and manner of disclosure and the timing and frequency of disclosure. While the Commission is providing flexibility with regard to the form and manner of disclosure as well as timing and frequency, the adequacy of disclosure will depend on the facts and circumstances.[207] In order to

[199] *See, e.g., Chasins* v. *Smith, Barney & Co.,* 438 F.2d 1167, 1172 (2d Cir. 1970) (''[F]ailure to inform the customer fully of its possible conflict of interest, in that it was a market maker in the securities which it strongly recommended for purchase by [plaintiff], was an omission of material fact in violation of Rule 10b–5.''); *United States* v. *Laurienti,* 611 F.3d 530, 541 (9th Cir. 2010) (emphasizing that ''even in a trust relationship, a broker is required to disclose only *material* facts'' and that ''materiality is defined by the nature of the trust relationship between the clients and the brokers: 'This relationship places an affirmative duty on brokers to use reasonable efforts to give the customer information relevant to the affairs that have been entrusted to them.''') quoting *United States* v. *Szur,* 289 F.3d 200, 211 (2d Cir. 2002)).

[200] This interpretation is consistent with the 913 Study recommendation. *See* 913 Study at 112.

[201] *See* SIFMA 2017 Letter (''Likewise, consistent with our prior written advocacy on this issue, the new standard would not prohibit BDs from offering any of the following, if accompanied by appropriate disclosure, and the product or service is in the best interest of the customer: (1) Proprietary products or services (including those from affiliates); (2) transaction charge-based accounts (*e.g.,* commissions); (3) complex products (*e.g.,* structured products, alternative investments such as hedge funds and private equity funds, etc.); and . . .'').

[202] Broker-dealers may offer a limited range of products, for instance, products sponsored or managed by an affiliate or products with third-party arrangements (*e.g.,* revenue sharing).

[203] *See, e.g.,* IFG Network Sec., Inc., Exchange Act Release No. 54127 (July 11, 2006) (Commission Decision).

[204] For example, firms and their registered representatives that recommend an investor roll over plan assets to an IRA may earn commissions or other fees as a result, while a recommendation that a retail customer leave his plan assets with his old employer or roll the assets to a plan sponsored by a new employer likely results in little or no compensation for a firm or a registered representative. *See* FINRA Regulatory Notice 13–45.

[205] *See* Sections 10(b) and 15(c) of the Exchange Act. *See, e.g.,* Exchange Act Rule 10b–10 (Confirmation of Transactions) Preliminary Note (requiring broker-dealers to disclose specified information in writing to customers at or before completion of the transactions). For example, a broker-dealer may be required to disclose revenue sharing payments that it or its affiliates may receive for distributing fund shares from a fund's investment adviser or others. Those payments provide sales incentives that create conflicts between broker-dealers' financial interests and their agency duties to customers. Revenue sharing payments may lead a broker-dealer to use ''preferred lists'' that explicitly favor the distribution of certain funds. Revenue sharing payments also may lead to favoritism that is less explicit but just as real, such as through broker-dealer practices allowing funds that make revenue sharing payments to have special access to broker-dealer sales personnel, and through other incentives or instructions that a broker-dealer may provide to managers or salespersons. *See, e.g., In re Edward D. Jones & Co,* Securities Act Release No. 8520 (Dec. 22, 2004) (broker-dealer violated antifraud provisions of Securities Act and Exchange Act by failing to disclose conflicts of interest arising from receipt of revenue sharing, directed brokerage payments and other payments from ''preferred'' families that were exclusively promoted by broker-dealer); *In re Morgan Stanley DW Inc.,* Securities Act Release No. 8339 (Nov. 17, 2003) (broker-dealer violated antifraud provisions of Securities Act by failing to disclose special promotion of funds from families that paid revenue sharing and portfolio brokerage).

[206] *See* TIAA Letter; Bernardi Letter; ACLI Letter. *But see* UBS Letter; Nationwide Letter; FSR Letter (suggesting the SEC require a disclosure document similar to Form ADV).

[207] For example, the Commission has indicated that failure to disclose the nature and extent of a conflict of interest may violate Securities Act Section 17(a)(2). *See Edward D. Jones & Co., L.P.,* Exchange Act Release No. 50910 (Dec. 22, 2004); *Morgan Stanley DW, Inc.,* Exchange Act Release No. 48789 (Nov. 17, 2003). In the context of scalping, it is misleading to disclose that the person making the investment recommendation ''may'' trade the recommended securities when in fact the person does so. In *SEC* v. *Blavin,* for example, the Sixth Circuit held that a newsletter publisher could not avoid liability for scalping under Section 10(b) and Rule 10b–5 of the Exchange Act by disclosing that it ''may trade for its own account.'' 760 F.2d at 709–11. The court found that this was a material misstatement because in fact it did trade for its own account. *See id.; see also SEC* v. *Gane,* 2005 WL 90154 at *14 (S.D. Fla., Jan. 4, 2005) (''By stating that they, their affiliates, officers, directors, or employees 'may' buy or sell stock in their Investment Opinions, Southern Financial and

Continued

''reasonably disclose'' in accordance with this Disclosure Obligation, a broker-dealer would need to give sufficient information to enable a retail customer to make an informed decision with regard to the recommendation.[208] Disclosures made pursuant to the Disclosure Obligation must be true and may not omit any material facts necessary to make the required disclosures not misleading.[209]

In addition to providing firms flexibility, we further believe it is important to require that broker-dealers or natural persons who are associated persons of the broker-dealer to ''reasonably disclose'' so that compliance with the Disclosure Obligation will be measured against a negligence standard, not against a standard of strict liability.[210] In taking this position, we are sensitive to the potential that, if we instead proposed an express obligation that broker-dealers ''disclose material facts relating to the scope and terms of the relationship with the retail customer and material conflict of interest,'' broker-dealers, in an effort to avoid any inadvertent failure to disclose this information as required, could opt to disclose *all* facts and conflicts (including those that do not meet the materiality threshold). This could result in lengthy disclosures that do not meaningfully convey the material facts and material conflicts of interest and may undermine the Commission's goal of facilitating disclosure to assist retail customers in making informed investment decisions.

Given the unique structure and characteristics of the broker-dealer relationship with retail customers—including the varying levels and frequency of recommendations that may be provided, and the types of conflicts that may be presented—we believe it is important to provide broker-dealers flexibility in determining the most appropriate and effective way to meet this Disclosure Obligation, consistent with the principles set forth below. Accordingly, at this time we are not proposing to require a standard written document akin to Form ADV Part 2A, as suggested by certain commenters. As discussed in more detail below, we preliminarily believe that while some forms of disclosure may be standardized, certain disclosures may need to be tailored to the particular recommendation, and some disclosures may be addressed through an initial more generalized disclosure about the material fact or conflict, followed by specific disclosure at another point. Accordingly, we have preliminarily determined to provide flexibility in the form and manner, and timing and frequency, of the disclosure.

(1) Form and Manner of Disclosure

The Commission believes that disclosure should be concise, clear and understandable to promote effective communication between a broker-dealer and retail customer.[211] Specifically, broker-dealers generally should apply plain English principles to written disclosures including, among other things, the use of short sentences and active voice, and avoidance of legal jargon, highly technical business terms, or multiple negatives.[212] Broker-dealers may also, for example, consider whether the use of graphics could help investors better understand and evaluate these disclosures. Additionally, we believe that any such disclosure must be provided in writing in order to facilitate investor review of the disclosure, promote compliance by firms, facilitate effective supervision, and facilitate more effective regulatory oversight to help ensure and evaluate whether the disclosure complies with the requirements of Regulation Best Interest.[213] As with other documents broker-dealers must deliver, broker-dealers would be able to deliver the disclosure required pursuant to Regulation Best Interest consistent with the Commission's guidance regarding electronic delivery of documents.[214]

As described above, we are not proposing to specify by rule the form (*e.g., narrative* v. *graphical/tabular, number of pages, etc.*) or manner (*e.g.,* relationship guide or other written communications) of disclosure. Given the variety of ways retail customers may communicate with their broker-dealer, as well as the type of compensation and other conflicts presented and the variety in the frequency and level of advice services provided (*i.e.,* one-time,

Strategic investors failed to provide adequate disclosure'').

[208] *See, e.g., De Kwiatkowski,* 306 F.3d 1293, *supra* notes 15 (''the broker . . . is obliged to give honest and complete information when recommending a purchase or sale.'') and 176; *see also Arleen W. Hughes,* Exchange Act Release No. 4048, *supra* note 143 (finding duty to disclose material facts ''in a manner which is clear enough so that a client is fully apprised of the facts and is in a position to give his informed consent'').

[209] As noted, Regulation Best Interest applies in addition to any obligations under the Exchange Act, along with any rules the Commission may adopt thereunder, and any other applicable provisions of the federal securities laws and related rules and regulations. For example, any transaction or series of transactions, whether or not subject to the provisions of Regulation Best Interest, remain subject to the antifraud and anti-manipulation provisions of the securities laws, including, without limitation, Section 17(a) of the Securities Act [15 U.S.C. 77q(a)] and Sections 9, 10(b), and 15(c) of the Exchange Act [15 U.S.C. 78i, 78j(b), and 78o(c)] and the rules thereunder.

[210] While we understand that pursuant to the fiduciary duty under the Advisers Act Section 206(1) and (2), an investment adviser must eliminate, or at least disclose, all conflicts of interest, as this duty is derived from the antifraud provisions, it is not a strict liability standard. *See In the Matter of Cranshire Capital Advisors LLC,* Investment Advisers Act Release No. 4277 (Nov. 23, 2015); *SEC* v. *Capital Gains Research Bureau, Inc.* In particular, scienter is required to establish violations of Section 206(1) of the Advisers Act. *SEC* v. *Steadman,* 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). However, scienter is not required to establish a violation of Section 206(2) of the Advisers Act; a showing of negligence is adequate. *See SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 195 (1963); *see also SEC* v. *Steadman,* 967 F.2d at 643 & n.5; *Steadman* v. *SEC,* 603 F.2d 1126, 1132–34 (5th Cir. 1979), *aff'd on other grounds,* 450 U.S. 91 (1981).

The DOL Fiduciary Rule also would avoid strict liability, albeit through a ''good faith'' exemption in its BIC Exemption. Section II(e)(8), BIC Exemption Release at 21046–21047.

[211] Exchange Act Section 15(l)(1) and Advisers Act Section 211(h)(1) provide that the Commission shall ''facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers and investment advisers, including any material conflicts of interest.''

[212] *See* Office of Investor Education and Assistance, U.S. Securities and Exchange Commission, *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (Aug. 1998). *See also* Relationship Summary Proposal.

[213] We recognize that broker-dealers may provide recommendations by telephone. In such instances, we believe that a broker-dealer could meet its obligation to reasonably disclose ''in writing,'' ''prior to or at the time of such recommendation'' through a variety of approaches, as described *infra* in Section II.D.1.c.(2). For example, the broker-dealer may have already provided relevant disclosures prior to the telephone conversation (*e.g.,* in a relationship guide, an account opening agreement or account disclosure). The broker-dealer may also be able to meet the delivery obligation by sending the relevant disclosure electronically (*e.g.,* by email) to the retail customer during the telephone conversation. *See also, infra* note 216 and accompanying text, where we explain that we would not consider the disclosure of capacity at the time of recommendation to also be subject to the ''in writing'' requirement (*i.e.,* a broker-dealer could clarify it orally, so long as it had previously provided an initial disclosure setting forth when the broker-dealer is acting in a broker-dealer capacity and the method it will use to clarify the capacity in which it is acting at the time of the recommendation).

[214] *See generally* Use of Electronic Media for Delivery Purposes, Exchange Act Release No. 36345 (Oct. 6, 1995) (''1995 Release'') (providing Commission views on the use of electronic media to deliver information to investors, with a focus on electronic delivery of prospectuses, annual reports to security holders and proxy solicitation materials under the federal securities laws); Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Exchange Act Release No. 37182 (May 9, 1996) (''1996 Release'') (providing Commission views on electronic delivery of required information by broker-dealers, transfer agents and investment advisers); Use of Electronic Media, Exchange Act Release No. 42728 (Apr. 28, 2000) (''2000 Release'') (providing updated interpretive guidance on the use of electronic media to deliver documents on matters such as telephonic and global consent; issuer liability for website content; and legal principles that should be considered in conducting online offerings).

episodic or on a more frequent basis), we believe that some disclosures may be effectively provided in a standardized document at the beginning of the relationship, whereas others may need to be tailored to a particular recommendation. Accordingly, we preliminarily believe that broker-dealers should have the flexibility to make disclosures by various means (*e.g.,* different types of disclosure documents), as opposed to requiring a single standard written document. As noted, however, whether there is sufficient disclosure will depend on the facts and circumstances.

(2) Timing and Frequency of Disclosure

The Disclosure Obligation would apply ''prior to or at the time of'' the recommendation. The timing of the disclosure is critically important to whether it may achieve the effect contemplated by the proposed rule. Investors should receive information early enough in the process to give them adequate time to consider the information and promote the investor's understanding in order to make informed investment decisions, but not so early that the disclosure fails to provide meaningful information (*e.g.,* does not sufficiently identify material conflicts presented by a particular recommendation, or overwhelms the retail customer with disclosures related to a number of potential options that the retail customer may not be qualified to pursue). The timing of the required disclosure should also reflect the various ways in which retail customers may receive recommendations and convey orders.[215]

In light of these goals, we would like to emphasize the importance of determining the appropriate timing and frequency of disclosure that may be effectively provided ''prior to or at the time of'' the recommendation, but which may be achieved through a variety of approaches: (1) At the beginning of a relationship (*e.g.,* in a relationship guide, such as or in addition to the Relationship Summary, or in written communications with the retail customer, such as the account opening agreement); (2) on a regular or periodic basis (*e.g.,* on a quarterly or annual basis, when any previously disclosed information becomes materially inaccurate, or when there is new relevant material information); (3) at other points, such as before making a particular recommendation or at the point of sale; and/or (4) at multiple points in the relationship or through a layered approach to disclosure. For example, a broker-dealer may determine that certain disclosures may be most effective if they are made at multiple points in the relationship, or, if pursuant to a layered approach to disclosure, certain material facts are conveyed in a more general manner in an initial written disclosure and followed by more specific information in a subsequent disclosure, which may be at the time of the recommendation[216] or even after the recommendation (*i.e.,* in the trade confirmation). Disclosure after the recommendation, such as in a trade confirmation for a particular recommended transaction would not, by itself, satisfy the Disclosure Obligation, because the disclosure would not be ''prior to, or at the time of the recommendation.'' However, a broker-dealer could satisfy the Disclosure Obligation, depending on the facts and circumstances, if the initial disclosure, in addition to conveying material facts relating to the scope and terms of the relationship with the retail customer, explains when and how a broker-dealer would provide additional more specific information regarding the material fact or conflict in a subsequent disclosure (*e.g.,* disclosures in a trade confirmation concerning when the broker-dealer effects recommended transactions in a principal capacity).We believe that including in the general disclosure this additional information of when and how more specific information will be provided would help the retail customer understand the general nature of the information provided and alert the retail customer that more detailed information about the fact or conflict would be provided and the timing of such disclosure.[217] As noted above, whether there is sufficient disclosure in both the initial disclosure and any subsequent disclosure, will depend on the facts and circumstances.

The Commission anticipates that broker-dealers may elect to make certain required disclosures of information to their customers at the beginning of a relationship, such as in a relationship guide, account agreement, comprehensive fee schedule, or other written document accompanying such documents. While certain forms of disclosure may be standardized, certain disclosures may need to be tailored to a particular recommendation, for example, if the standardized disclosure does not sufficiently identify the material conflicts presented by the particular recommendation. Furthermore, additional disclosure may be needed beyond the standardized disclosure (such as an account agreement) when any previously provided information becomes materially inaccurate, or when there is new relevant material information (*e.g.,* a new material conflict of interest has arisen that is not addressed by the standardized disclosure). Because the Disclosure Obligation would apply ''prior to or at the time of'' the recommendation, if a broker-dealer has previously made the relevant disclosure to the retail customer (and there have been no material changes to the previously disclosed information), it would not be expected to repeat such disclosure at each subsequent recommendation, depending on the facts and circumstances of the prior disclosure. As noted above, we would like to emphasize the importance of determining the appropriate timing and frequency of disclosure. For example, where a significant amount of time passes between the disclosure and a recommendation, the broker-dealer generally should determine whether the retail customer should reasonably be

[215] *See, e.g.,* note 160 *supra,* describing ''check and application'' arrangements.

[216] For example, as discussed above in the discussion of the disclosure of the capacity in which the broker-dealer is acting, a broker-dealer may take this type of approach with respect to meeting its obligation regarding the capacity in which it is acting at the time of the recommendation. As noted above, we preliminarily believe that a broker-dealer would satisfy the Disclosure Obligation expressly by providing written disclosure setting forth when the broker-dealer is acting in a broker-dealer capacity versus an advisory capacity and how the broker-dealer will clarify when it is making a recommendation whether it is doing so in a broker-dealer capacity versus an advisory capacity. However, one important distinction is that the written disclosure requirement would apply to the initial disclosure (*i.e.,* setting forth when the broker-dealer is acting in a broker-dealer capacity and the method it will use to clarify the capacity in which it is acting at the time of the recommendation), but we would not consider the subsequent disclosure of capacity at the time of recommendation to also be subject to the ''in writing'' requirement (*i.e.,* a broker-dealer could clarify it orally).

[217] The Commission has granted exemptions to certain dual registrants, subject to a number of conditions, from the written disclosure and consent requirements of Advisers Act Section 206(3) (which makes it unlawful for an adviser to engage in a principal trade with an advisory client, unless it discloses to the client in writing before completion of the transaction the capacity in which the adviser is acting and obtains the consent of the client to the transaction). The exemptions are subject to several conditions, including conditions to provide disclosures at multiple points in the relationship, including disclosure that the entity may be acting in a principal capacity in a written confirmation at or before completion of a transaction. *See, e.g.,* In the matter of Merrill Lynch Pierce Fenner & Smith, Incorporated, Investment Advisers Act Release No. 4595; (Dec. 28, 2016); In the matter of Robert W. Baird & Co., Incorporated, Investment Advisers Act Release No. 4596 (Dec. 28, 2016); In the matter of UBS Financial Services, Inc., Investment Advisers Act Release No. 4597 (Dec. 28, 2016); In the matter of Wells Fargo Advisors, LLC, Wells Fargo Advisors Financial Network, LLC, Investment Advisers Act Release No. 4598 (Dec. 28, 2016).

expected to be on notice of the prior disclosure; if not, the broker-dealer generally should not rely on such disclosure.

The Commission preliminarily believes this flexible approach to disclosure is consistent with the broker-dealers' liabilities or obligations under the antifraud provisions of the federal securities laws.[218]

d. Consistency With Other Approaches

We believe that the proposed Disclosure Obligation, in conjunction with the Relationship Summary and Regulatory Status Disclosure noted above is consistent with many of the principles underlying the disclosure recommendation regarding disclosure in the 913 Study and behind the disclosure obligations of the BIC Exemption—which we believe is to facilitate disclosure and retail customer understanding of the key information material to a retail customer's relationship with a broker-dealer, including the scope and terms of the relationship and material conflicts of interest —and provides much of the same information, but in a less prescriptive manner that is designed to provide firms flexibility in how to satisfy the obligation.

Specifically, broker-dealers relying on the BIC Exemption to provide investment advice to retirement accounts would need to do so pursuant to a written contract that includes specific language and disclosures, including, among others, provisions: Acknowledging fiduciary status; committing the firm and the adviser to adhere to standards of impartial conduct; and warranting the adoption of policies and procedures reasonably designed to ensure that advisers provide best interest advice and minimize the harmful impact of conflicts of interest. The firm would also need to disclose information on the firm's and advisers' conflicts of interest and the cost of their advice and provide certain ongoing web disclosures.[219]

As previously noted, the 913 Study recommended that the Commission engage in rulemaking and/or issue interpretive guidance on the components of the recommended uniform fiduciary standard: The duties of loyalty and care.[220] With respect to disclosure obligations under the Duty of Loyalty, the 913 Study recommended the Commission facilitate the provision of uniform, simple, and clear disclosures to retail customers about the terms of the relationships with broker-dealers and investment advisers, including any material conflicts of interest. The 913 Study also recommended that the Commission consider disclosures that should be provided (a) in a general relationship guide akin to Form ADV Part 2A and (b) more specific disclosures at the time of providing investment advice, as well as consider the utility and feasibility of a summary disclosure document containing key information on a firm's services, fees, and conflicts and the scope of its services. Finally, the 913 Study recommended the Commission consider whether rulemaking would be appropriate to prohibit certain conflicts, to require firms to mitigate conflicts through specific action, or to impose specific disclosure and consent requirements.[221]

We believe that our proposed Disclosure Obligation, in conjunction with the Relationship Summary and Regulatory Status Disclosure noted above, would address many of the underlying concerns of and would provide customers with substantially similar information as required under the BIC Exemption and recommended in the 913 Study.

The Disclosure Obligation under Regulation Best Interest further builds on and complements the Relationship Summary and Regulatory Status Disclosure and together, these obligations would clarify the capacity in which a firm or financial professional is acting, in an effort to minimize investor confusion, and facilitate greater awareness of key aspects of a relationship with a firm or financial professional through a layered approach to disclosure.

e. Request for Comment on Proposed Disclosure Obligation

The Commission generally requests comment on the Disclosure Obligation. In addition, the Commission requests comment on the following specific issues:

- Would the Disclosure Obligation cause a broker-dealer to act in a manner that is consistent with what a retail customer would reasonably expect from someone who is required to act in his or her best interest? Why or why not?
- Should the Commission require new disclosure, beyond that which is currently required pursuant to common law, and Exchange Act and SRO rules?
- Should the Commission promulgate more specific disclosure requirements such as written account disclosure akin to Form ADV Parts 2A and 2B?
- Should the Commission require a specific type or amount of disclosure? What criteria should determine or inform the type or amount of disclosure?
- Should the Commission explicitly require that the disclosure be ''full and fair''? Why or why not?
- Should the Commission require broker-dealers to ''reasonably disclose'' as proposed? Should the Commission provide additional guidance as to how broker-dealers can meet that standard? If so, what additional guidance would commenters recommend? Should the

[218] For example, generally, under the antifraud provisions, whether a broker-dealer has a duty to disclose material information to its customer depends upon the scope of the relationship with the customer, which is fact-intensive. *See, e.g., Conway* v. *Icahn & Co., Inc.,* 16 F.3d 504, 510 (2d Cir. 1994) (''A broker, as agent, has a duty to use reasonable efforts to give its principal information relevant to the affairs that have been entrusted to it.''). Where a broker-dealer processes its customer's orders, but does not recommend securities or solicit customers, then the material information that the broker-dealer is required to disclose to its customer is narrow, encompassing only the information related to the consummation of the transaction. *See Press* v. *Chemical Inv. Servs. Corp.,* 166 F.3d 529, 536 (2d Cir. 1999). In such circumstances, the broker-dealer generally does not have to provide information regarding the security or the broker-dealer's economic self-interest in the security. *See, e.g., Carras* v. *Burns,* 516 F.2d 251, 257 (4th Cir. 1975) (broker-dealer not required to volunteer advice where ''acting only as a broker''); *Canizaro* v. *Kohlmeyer & Co.,* 370 F. Supp. 282, 289 (E.D. La. 1974), aff'd, 512 F.2d 484 (5th Cir. 1975) (broker-dealer that ''merely received and executed a purchase order, has a minimal duty, if any at all, to investigate the purchase and disclose material facts to a customer''); *Walston & Co.* v. *Miller,* 410 P.2d 658, 661 (Ariz. 1966) (''The agency relationship between customer and broker normally terminates with the execution of the order because the broker's duties, unlike those of an investment advisor or those of a manager of a discretionary account, are only to fulfill the mechanical, ministerial requirements of the purchase and sale of the security or future contract on the market.'').

See also Exchange Act Rule 10b–10 (''Rule 10b–10''). Rule 10b–10 requires a broker-dealer effecting customer transactions in securities (other than U.S. savings bonds or municipal securities) to provide written notification to the customer, at or before completion of the transaction, disclosing information specific to the transaction, including whether the broker-dealer is acting as agent or principal and its compensation, as well as any third-party remuneration it has received or will receive. Exchange Act Rules 15c1–5 and 15c1–6 also require a broker-dealer to disclose in writing to the customer if it has any control, affiliation, or interest in a security it is offering or the issuer of such security. The Commission and the SROs have also adopted rules designed to address conflicts of interest that can arise when security analysts recommend equity securities in research reports and public appearances. *See* Regulation Analyst Certification, or Regulation AC. Regulation AC requires that broker-dealers include certifications by the research analyst in research reports and disclose whether or not the research analyst received compensation or other payments in connection with his or her specific recommendations or reviews. *See also* FINRA Rule 2241 (imposing requirements on FINRA members to address conflicts of interest relating to the publication and distribution of equity research reports).

[219] *See* BIC Exemption.

[220] *See* 913 Study at 112.

[221] *See* 913 Study at 114–18.

Commission consider a different approach, such as a ''good faith'' exemption? Why or why not?

• Do commenters believe that the Disclosure Obligation requires disclosure of information that investors would not find useful? If so, please specify what information and why.

• Is there additional information that investors would find useful? If so, please specify what information and why.

• The Commission requests comment on existing broker-dealer disclosure practices. Do broker-dealers currently provide disclosures that could satisfy this requirement? If so, what types of disclosures and when/how are they delivered? Do broker-dealers provide customer-specific disclosures indicating what type of account is held and in what capacity the firm is acting? If so, how are those disclosures made (*e.g.,* on account statements) and at what time(s)? How do broker-dealers provide disclosures when making recommendations on the phone? Do all broker-dealers provide such disclosures, or only some broker-dealers? If only some, how many and under what circumstances? Are those disclosures written and presented in a manner consistent with the preliminary guidance on disclosure in this release? Please provide examples.

• Do broker-dealers currently provide more detailed disclosures than contemplated to be required as part of the Relationship Summary regarding the nature and scope of services provided, as well as the legal obligations and duties that apply to those services? If so, how and when is such disclosure provided (*e.g.,* in the account agreement or other document)? Please provide examples. To what extent do retail customers read and/or understand these disclosures? How effective are these disclosures and how consistent are they with the plain language and other principles of reasonable disclosure described above? How would we ensure that any disclosures are understood by retail investors?

• Would the Relationship Summary achieve the goal of the Disclosure Obligation of facilitating the retail customer's awareness of the material facts relating to the scope and terms of the relationship with the retail customer and all material conflicts of interest associated with the recommendation without the additional Disclosure Obligation? Should the Commission consider permitting broker-dealers to satisfy their obligations under this requirement solely by delivering the proposed Relationship Summary? Do commenters believe the Relationship Summary would ever fulfill the Disclosure Obligation? When would it? When would it not?

• The Commission has identified certain topics that would generally be considered material facts relating to the scope and terms of the relationships (*i.e.,* capacity, fees and services). Do commenters have examples of other information relating to scope and terms of the relationship that should be highlighted by the Commission as likely to be considered material facts that would need to be disclosed? If so, please provide examples. Should the Commission provide further guidance on such additional material facts? Should the Commission articulate these specific material facts (*e.g.,* capacity, fees and services) as required disclosures in the rule text (*e.g.,* by defining ''material facts relating to the scope and terms of the relationship'')? Why or why not?

• Should the Commission require additional disclosures for dual-registrants, as suggested above, because the Relationship Summary and Regulatory Status Disclosure for dual-registrants would describe both brokerage and advisory services/capacities?

• Should the Commission articulate additional requirements or guidance for a dual-registrant to satisfy the Disclosure Obligation? If so, what additional requirements or guidance and why? Should dual-registrants be required to disclose, in writing, each time they change capacity?

• The Commission proposes to provide flexibility to a broker-dealer that is a dual-registrant to determine how to disclose that it is acting in a broker-dealer capacity. How do commenters anticipate that dual-registrants will meet this obligation? Specifically, how do commenters expect dual-registrants to meet the obligation to provide such disclosure ''prior to or at the time of'' a recommendation in their capacity as a broker-dealer? Should a broker-dealer be required to make a customer-specific or recommendation-specific disclosure about the capacity in which it is acting? Should that disclosure be made on a one-time or ongoing basis? Should the Commission mandate the form or method of delivery of that disclosure? For example, should the Commission require broker-dealers to include the disclosure in account opening forms or periodic statements or in other documents?

• Does the guidance concerning additional more detailed disclosures that broker-dealers should consider providing in furtherance of layered disclosure cause confusion about the level of disclosure firms are required to make in order to satisfy the requirement to disclose the terms and scope of the relationship? If so, how could the Commission clarify this guidance? Would the layered disclosure approach cause confusion among retail customers?

• The Commission requests comment on existing broker-dealer practices concerning fee disclosures. What types of fee disclosures do broker-dealers currently provide? Do broker-dealers currently provide fee disclosures that could satisfy this requirement? If so, what types of disclosures and when/how are they delivered? Do broker-dealers provide customer-specific disclosures indicating what type of fees are charged, how they are identified (*e.g.,* on account statements?), and when/if they change? Please provide examples.

• Should the Commission mandate the form, specific content or method for delivering fee disclosure? Why or why not? Do commenters believe that disclosure of fees in a uniform manner would be beneficial for investors? If so, what would be the preferred style of such disclosure in order to facilitate investor comprehension of such fees?

• The Commission preliminarily believes that broker-dealers should be required to disclose, at a minimum, the types of fees that are included in the Relationship Summary. Should the Commission provide more clarity regarding what types of fees should be disclosed? Should the Commission add a materiality threshold for fee disclosure?

• Should the Commission mandate a comprehensive fee schedule? Why or why not? If so, should the Commission mandate the form, specific content or method of delivering the comprehensive fee schedule?

• Should broker-dealers be required to update fee disclosures 30 days or another specified time period before they raise fees or impose new fees? Should this requirement be limited to material fees? How should such fees be defined?

• Should broker-dealers be required to use specified terms to describe certain material fees? If so, what should those specified terms be?

• As proposed, the rule only requires disclosure to retail customers who receive recommendations. Should the Commission consider requiring fee disclosure to all retail customers, including customers in self-directed brokerage accounts? Why or why not?

• Would self-directed customers benefit from more detailed fee disclosure? If so, in what form should the disclosure to self-directed customers be provided, and what should be the scope of fee information provided?

- Regarding timing of disclosure, the Commission preliminarily believes that the disclosure should be made ''prior to or at the time of'' the recommendation. Should the Commission consider a different timing requirement? For example, should the Commission require disclosure ''immediately prior to the recommendation''? Should the Commission instead mandate the timing and frequency of certain disclosures? If so, which disclosures should be subject to more specific timing or updating requirements? For example, should the Commission require annual delivery of certain disclosure, such as fee disclosures? Why or why not?
- Do commenters agree that in certain circumstances broker-dealers should be permitted to provide an initial disclosure followed by more specific disclosure after the recommendation? Why or why not? Do commenters require more guidance on when this would be permitted? If so, how could the Commission clarify this guidance?
- Are there services, in addition to those provided as examples, that should be considered material facts relating to the scope of terms of the relationships? If so, please explain. Are there specific types of services that broker-dealers provide that should be required to be disclosed? If so, which ones?
- Should the Commission require specific disclosures on products and product limitations? Why or why not?
- Should broker-dealers be subject to more specific requirements concerning the method of disclosures? If so, what additional requirements should the Commission consider, and why? If not, why not? For example, should the Commission impose requirements concerning prominence or method of delivery?
- Do commenters believe that all disclosures should be made in writing, as proposed? Should the Commission permit disclosures to be made orally, so long as a written record of the oral disclosure is made and retained?
- Should the Commission require that certain disclosures be made prior to the execution of a transaction? If so, which ones? Why or why not?
- Should broker-dealers be required to make certain disclosures before the first recommendation or transaction effected for a customer? If so, which ones? Why or why not?
- Are there any specific interactions or relationships between the disclosure requirements under the Disclosure Obligation and the Relationship Summary that should be addressed?
- Are there any specific interactions or relationships between the disclosure requirements under the Disclosure Obligation and the Conflict of Interest Obligations that should be addressed?
- Are there any specific interactions or relationships between the disclosure requirements in Regulation Best Interest and the existing general antifraud provisions that should be addressed? Do commenters believe the general antifraud provisions adequately address other non-recommendation related conflicts or should Regulation Best Interest also cover such conflicts?

The Commission requests comment on the proposed requirement to disclose all material conflicts of interest associated with the recommendation.

- Should the Commission require such disclosures?
- Should the Commission use a different interpretation for what is a ''material conflict of interest''? If so, which one and why?
- Should the Commission define ''material conflicts of interest'' in terms of an incentive that causes a broker-dealer not to act in the retail customer's best interest? Why or why not?
- Are there any types of material conflicts that commenters believe the Commission should require to be disclosed? If so, which ones and why?
- Are there any material conflicts of interest that commenters believe cannot be disclosed sufficiently in writing? If so, which conflicts and why?
- Should the Commission require a specific type or amount of disclosure? What criteria should determine or inform the type or amount of disclosure?
- Should the disclosure requirements include quantification of conflicts of interest, the economic benefits from material conflicts of interest to firms and their associated persons, or the costs of such conflicts to retail customers or clients?
- Given the number of dually-registered representatives, would the existence of written disclosure in Form ADV Part 2B, including disclosure about financial incentives such as conflicts from compensation received in association with a broker-dealer, in the absence of comparable written disclosure expressly relating to other conflicts that may affect the same representative's recommendations in a broker-dealer capacity, create a misleading impression about the representative's conflicts or their potential impact on advice in a broker-dealer rather than an adviser capacity?
- Are there particular material conflicts arising from financial incentives or other material conflicts that the Commission should specifically require a broker-dealer to disclose to a retail customer? If so, which ones and why? If not, why not? Are there any for which the Commission should specifically require advance customer written consent? If so, which and why?

2. Care Obligation

The Commission proposes to require, as part of Regulation Best Interest, a Care Obligation that would require a broker-dealer, when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer, to exercise reasonable diligence, care, skill, and prudence to: (1) Understand the potential risks and rewards 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; (2) 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 and rewards associated with the recommendation; and (3) 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. These proposed obligations would require a broker-dealer making a recommendation of a securities transaction or investment strategy involving securities to a retail customer to have a reasonable basis for believing that the recommended transaction or investment strategy is in the best interest of the retail customer and does not put the financial or other interest of the broker-dealer before that of the retail customer.[222] The Care Obligation is intended to incorporate and enhance existing suitability requirements applicable to broker-

[222] Under Regulation Best Interest, as proposed, a broker-dealer's duty to exercise reasonable diligence, care, skill and prudence is designed to be similar to the standard of conduct that has been imposed on broker-dealers found to be acting in a fiduciary capacity. *See, e.g., Davis* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 906 F.2d 1206, 1215 (8th Cir. 1990) (the district court did not abuse its discretion in instructing the jury that licensed securities brokers were fiduciaries that owed their customers a duty of utmost good faith, integrity and loyalty); *see also Paine, Webber, Jackson & Curtis, Inc.* v. *Adams,* 718 P.2d 508, 515–16 (Colo. 1986) (evidence ''that a customer has placed trust and confidence in the broker'' by giving practical control of account can be ''indicative of the existence of a fiduciary relationship''); *SEC* v. *Ridenour,* 913 F.2d. 515 (8th Cir. 1990) (bond dealer owed fiduciary duty to customers with whom he had established a relationship of trust and confidence).

dealers under the federal securities laws by, among other things, imposing a "best interest" requirement which we would interpret to require the broker-dealer not put its own interest ahead of the retail customer's interest, when making recommendations.[223]

Although the term "prudence" is not a term frequently used in the federal securities laws,[224] the Commission believes that this term conveys the fundamental importance of conducting a proper evaluation of any securities recommendation in accordance with an objective standard of care. However, recognizing that the term "prudence" is generally not used under the federal securities laws, we also seek comment below on whether there is adequate clarity and understanding regarding its usage, or whether other terms are more appropriate in the context of broker-dealer regulation.

Under the Care Obligation, a broker-dealer generally should consider reasonable alternatives, if any, offered by the broker-dealer in determining whether it has a reasonable basis for making the recommendation. This approach would not require a broker-dealer to analyze all possible securities, all other products, or all investment strategies to recommend the single "best" security or investment strategy for the retail customer, nor necessarily require a broker-dealer to recommend the least expensive or least remunerative security or investment strategy.[225] Nor does Regulation Best Interest prohibit, among others, recommendations from a limited range of products, or recommendations of proprietary products, products of affiliates, or principal transactions, provided the Care Obligation is satisfied and the associated conflicts are disclosed (and mitigated, as applicable) or eliminated, as discussed in Sections II.B. and II.D.2.

a. Understand the Potential Risks and Rewards of the Recommended Transaction or Strategy, and Have a Reasonable Basis To Believe That the Recommendation Could Be in the Best Interest of at Least Some Retail Customers

Broker-dealers must deal with their customers fairly[226]—and, as part of that obligation, have a reasonable basis for any recommendation.[227] This obligation stems from the broker-dealer's "special relationship" to the retail customer, and from the fact that in recommending a security or investment strategy, the broker-dealer represents to the customer "that a reasonable investigation has been made and that [its] recommendation rests on the conclusions based on such investigation."[228]

Paragraph (a)(2)(ii)(A) of proposed Regulation Best Interest, which is intended to incorporate a broker-dealer's existing obligations under "reasonable-basis suitability,"[229] would require a broker-dealer to "exercise reasonable diligence, care, skill, and prudence to . . . [u]nderstand the potential risks and rewards 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."[230] This obligation would relate to the particular security or strategy recommended, rather than to any particular retail customer.[231] Without establishing such a threshold understanding of its particular recommendation, we do not believe that a broker-dealer could, as required by Regulation Best Interest, act in the best interest of a retail customer when making a recommendation.

To meet this proposed requirement under paragraph (a)(2)(ii)(A), a broker-dealer would need to: (1) Undertake reasonable diligence (*i.e.,* reasonable investigation and inquiry) to understand the potential risks and rewards of the recommended security or strategy (*i.e.,* to understand the security or strategy), and (2) have a reasonable basis to believe that the recommendation could be in the best interest of at least some retail customers based on that

[223] In response to Chairman Clayton's Statement, several commenters supporting a best interest standard for broker-dealers suggested that the best interest standard be built upon existing broker-dealer requirements, such as suitability, and include enhancements to those standards as the Commission sees necessary. *See, e.g.,* SIFMA 2017 Letter, John Hancock Letter; Fidelity Letter; Wells Fargo Letter; ICI August 2017 Letter. *See also supra* Section II.B.

[224] *But see SEC* v. *Glt Dain Rauscher, Inc.,* 254 F.3d 852, 853 (9th Cir. 2001) (where, in the context of an underwriter of municipal offerings who allegedly violated several federal securities laws, the court held "that the industry standard of care for an underwriter of municipal offerings is one of reasonable prudence, for which the industry standard is one factor to be considered, but is not the determinative factor"). In addition, under Section 11(c) of the Securities Act [15 U.S.C. 77k(c)], the adequacy of an underwriter's due diligence efforts and, in turn, its ability to establish a due diligence defense is determined by "the standard of reasonableness [that] shall be that required of a *prudent man in the management of his own property*" (emphasis added).

[225] *See supra* Section II.B.

[226] *See, e.g., Duker & Duker,* Exchange Act Release No. 2350, at *2, 6 SEC. 386, 388 (Dec. 19, 1939) (Commission opinion) ("Inherent in the relationship between a dealer and his customer is the vital representation that the customer be dealt with fairly, and in accordance with the standards of the profession."). *See also* Report of the Special Study of Securities Markets of the Securities and Exchange Commission, H. Doc. 95, 88th Cong., 1st Sess., at 238 (1963) ("An obligation of fair dealing, based upon the general antifraud provisions of the Federal securities laws, rests upon the theory that even a dealer at arm's length impliedly represents when he hangs out his shingle that he will deal fairly with the public.").

[227] *See Mac Robbins & Co.,* Exchange Act Release No. 6846, at *3 ("[T]he making of representations to prospective purchasers without a reasonable basis, couched in terms of either opinion or fact and designed to induce purchases, is contrary to the basic obligation of fair dealing borne by those who engage in the sale of securities to the public."), *aff'd sub nom., Berko* v. *SEC,* 316 F.2d 137 (2d Cir. 1963).

[228] *See Hanly,* 415 F.2d 596–97 ("A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents that he has an adequate and reasonable basis for the opinions he renders."); *In the Matter of Lester Kuznetz,* 1986 WL 625417 at *3, Exchange Act Rel. No. 23525 (Aug. 12, 1986) (Commission opinion) ("When a securities salesman recommends securities, he is under a duty to ensure that his representations have a reasonable basis."); *see also* FINRA Regulatory Notice 10–22, Obligation of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings (Apr. 2010).

[229] The courts, the Commission, and FINRA have interpreted the broker-dealer's existing reasonable-basis suitability obligation to impose a broad affirmative duty to have an "adequate and reasonable basis" for any recommendation that they make. *See, e.g., Hanly,* 415 F.2d 597; *see also SEC* v. *Hasho,* 784 F. Supp. 1059, 1107 (S.D.N.Y. 1992) ("By making a recommendation, a securities dealer implicitly represents to a buyer of securities that he has an adequate basis for the recommendation."); *Michael Frederick Siegel,* Exchange Act Rel. No. 58737, at *12–13 (Oct. 6, 2008) (Commission opinion) ("The suitability rule . . . requires that . . . a registered representative must first have an 'adequate and reasonable basis' for believing that the recommendation could be suitable for at least some customers."); *Terry Wayne White,* Exchange Act Rel. No. 27895, at *4, 50 SEC. 211, 212 & n.4 (1990) (Commission opinion) ("It is well established that a broker cannot recommend any security to a customer 'unless there is an adequate and reasonable basis for such recommendation. . . .'").

[230] Reasonable-basis suitability "requires that a representative ensure that he or she has an 'adequate and reasonable' understanding of an investment before recommending it to customers." *Richard G. Cody,* Exchange Act Release No. 64565, at *12 (May 27, 2011) (Commission opinion, sustaining FINRA findings) (citing *Hanly,* 415 F.2d at 597).

This understanding must include the " 'potential risks and rewards' and potential consequences of such recommendation." *See Richard G. Cody,* Exchange Act Release No. 64565, at *12 (May 27, 2011) (Commission opinion, sustaining FINRA findings) (internal citations omitted), *aff'd, Cody* v. *SEC,* 693 F.3d 251 (1st Cir. 2012); *F.J. Kaufman and Co. of Virginia and Frederick J. Kaufman, Jr.,* Exchange Act Release No. 27535, at *3, 50 SEC. 164 (Dec. 13, 1989) (Commission opinion, sustaining NASD findings) ("[A] broker cannot determine whether a recommendation is suitable for a specific customer unless the broker understands the potential risks and rewards inherent in that recommendation."). *See also* FINRA Regulatory Notice 11–02 (Jan. 2011).

[231] *See Michael Frederick Siegel,* Exchange Act Release No. 58737, at *12–13 (Oct. 6, 2008) (Commission opinion, sustaining NASD findings), *aff'd in relevant part, Siegel* v. *SEC,* 592 F.3d 147 (D.C. Cir. 2010), *cert. denied,* 560 U.S. 926 (2010).

understanding.[232] A broker-dealer must adhere to both components to meet its obligation under proposed paragraph (a)(2)(ii)(A).[233] Thus, a broker-dealer could violate the obligation if he or she did not understand the potential risks and rewards of the recommended security or investment strategy, even if the security or investment strategy could have been in the best interest for at least *some* retail customers.[234] In addition, if a broker-dealer understands the recommended security or investment strategy, he or she must still have a reasonable basis to believe that the security or investment strategy could be in the best interest of at least *some* retail customers.[235]

In general, what would constitute reasonable diligence under proposed paragraph (a)(2)(ii)(A) will vary depending on, among other things, the complexity of and risks associated with the recommended security or investment strategy and the broker-dealer's familiarity with the recommended security or investment strategy.[236] For example, the cost associated with a recommendation is ordinarily only one of many factors to consider when evaluating the risks and rewards of a subject security or investment strategy involving securities. Other factors may include, but are not limited to, the investment objectives, characteristics (including any special or unusual features), liquidity, risks and potential benefits, volatility, and likely performance of market and economic conditions, the expected return of the security or investment strategy, as well as any financial incentives to recommend the security or investment strategy.

While every inquiry will be specific to the broker-dealer and the investment or investment strategy, broker-dealers may wish to consider questions such as:

• Can less costly, complex, or risky products available at the broker-dealer achieve the objectives of the product?

• What assumptions underlie the product, and how sound are they? What market or performance factors determine the investor's return?

• What are the risks specific to retail customers? If the product was designed mainly to generate yield, does the yield justify the risk to principal?

• What costs and fees for the retail customer are associated with this product? Why are they appropriate? Are all of the costs and fees transparent? How do they compare with comparable products offered by the firm?

• What financial incentives are associated with the product, and how will costs, fees, and compensation relating to the product impact an investor's return?

• Does the product present any novel legal, tax, market, investment, or credit risks?

• How liquid is the product? Is there a secondary market for the product?[237]

This list of questions is not meant to be comprehensive, nor should it substitute for a broker-dealer's own assessment of what factors should be considered to determine the risks and rewards of a particular investment or investment strategy. However, it is meant to illustrate the types of questions and considerations a broker-dealer generally should consider when developing an understanding of the potential risks and rewards associated with a recommendation, and when developing a reasonable basis to believe that the recommended investment or investment strategy could be in the best interest of at least *some* retail customers.[238] If a broker-dealer cannot establish such a fundamental understanding of its recommendation (*i.e.,* the risks and rewards associated with the recommendation, or that the recommendation could be in the best interest of at least some retail customers), we do not believe that the broker-dealer could establish that it is acting in a retail customer's best interest when making a recommendation in accordance with proposed paragraph (a)(2)(ii)(B) of Regulation Best Interest.

b. Reasonable Basis To Believe the Recommendation Is in the Best Interest of a Particular Retail Customer

Beyond establishing an understanding of the recommended securities transaction or investment strategy, we believe that acting in the best interest of the retail customer would require a broker-dealer to have a reasonable basis to believe that a specific recommendation is in the best interest of the *particular* retail customer based on its understanding of the investment or investment strategy under proposed paragraph (a)(2)(ii)(A), and in light of the retail customer's investment objectives, financial situation, and needs. Accordingly, under proposed paragraph (a)(2)(ii)(B), the second obligation would require a broker-dealer to ''exercise reasonable diligence, care, skill, and prudence to . . . 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 and rewards associated with the recommendation.'' Under this standard, a broker-dealer could not have a reasonable basis to believe that the recommendation is in the ''best interest'' of the retail customer, if the broker-dealer put its interest ahead of the retail customer's interest, as discussed in Section II.B.

For the reasons set forth below, this proposed obligation is intended to incorporate a broker-dealer's existing well-established obligations under ''customer-specific suitability,'' [239] but

[232] *See* paragraph (a)(2)(ii)(A) of Proposed Regulation Best Interest; *see also Cody* v. *SEC,* 693 F.3d 251, 259 (1st Cir. 2012) (finding that registered representative was responsible for investigating security that he recommended and failed to have sufficient understanding of security); *F.J. Kaufman,* Exchange Act Release No. 27535, at *3 (''A broker-dealer in his dealings with customers impliedly represents that his opinions and predictions respecting a [security] which he has undertaken to recommend are responsibly made on the basis of actual knowledge and careful consideration . . . .''); *see also* FINRA Regulatory Notice 12–25 at Q22.

[233] *See* FINRA Rule 2110.05(a). *See also* FINRA Regulatory Notice 12–25 at Q22 (the ''reasonable-basis obligation has two components: A broker must (1) perform reasonable diligence to understand the nature of the recommended security or investment strategy involving a security or securities, as well as the potential risks and rewards, and (2) determine whether the recommendation is suitable for at least some investors based on that understanding''). In discussing SRO suitability rules, the Commission has noted that ''the 'reasonable-basis' test is subsumed within the [NASD's] suitability rule. A broker cannot conclude that a recommendation is suitable for a particular customer unless he has a reasonable basis for believing that the recommendation could be suitable for at least some customers.'' *Terry Wayne White,* Exchange Act Release No. 27895, at *2, 50 SEC. 211, 212–13 (Apr. 11, 1990) (Commission opinion, sustaining NASD findings) (citing *F.J. Kaufman,* Exchange Act Release No. 27535).

[234] *See* FINRA Regulatory Notice 12–25 at Q22 (noting that the ''reasonable-basis obligation is critically important because, in recent years, securities and investment strategies that brokers recommend to customers, including retail investors, have become increasingly complex and, in some cases, risky. Brokers cannot fulfill their suitability responsibilities to customers (including both their reasonable-basis and customer-specific obligations) when they fail to understand the securities and investment strategies they recommend. . . .''). Broker-dealers also have additional specific suitability obligations with respect to certain types of products or transactions, such as variable insurance products and non-traditional products, including structured products and security futures. *See, e.g.,* FINRA Rule 2330, ''Members' Responsibilities Regarding Deferred Variable Annuities;'' FINRA Rule 2370, ''Security Futures;'' *see also* 913 Study at 65–66.

[235] *See* FINRA Regulatory Notice 12–25 at Q22.

[236] *See* FINRA Rule 2111.05(a).

[237] *See* NASD Notice to Members 05–26, New Products—NASD Recommends Best Practices for Reviewing New Products (Apr. 2005).

[238] *See supra* note 233.

[239] *See, e.g., J. Stephen Stout,* Exchange Act Release No. 43410, at *11, 54 SEC. 888, 909 (Oct. 4, 2000) (Commission opinion) (''As part of a broker's basic obligation to deal fairly with customers, a broker's recommendation must be suitable for the client in light of the client's investment objectives, as determined by the client's financial situation and needs.''); *Richard N. Cea,*

enhances these obligations by requiring that the broker-dealer have a reasonable basis to believe that the recommendation is in the ''best interest'' of (rather than ''suitable for'') the retail customer. After extensive consideration of these existing customer-specific suitability requirements, we believe that it is appropriate to generally draw and build upon this existing obligation, as noted below, as the contours of the obligation are well-defined, and this approach would promote consistency and clarity in the relevant obligations, and facilitate the development of compliance policies and procedures for broker-dealers while also promoting investor protection.

Thus, under proposed Regulation Best Interest, the broker-dealer will be required to have a reasonable basis to believe, based on its diligence and understanding of the risks and rewards of the recommendation, and in light of the retail customer's investment profile, that the recommendation is in the best interest of the retail customer and does not place the broker-dealer's interest ahead of the customer's interest. We believe this will enhance the quality of recommendations, and will improve investor protection by minimizing the potential harmful impacts that broker-dealer conflicts of interest may have on recommendations provided to retail customers.

As described above, the broker-dealer's diligence and understanding of the risks and rewards would generally involve consideration of factors, such as the costs, the investment objectives and characteristics associated with a product or strategy (including any special or unusual features, liquidity, risks and potential benefits, volatility and likely performance in a variety of market and economic conditions), as well as the financial and other benefits to the broker-dealer.[240] Thus, in forming a reasonable basis to believe that the recommended securities transaction or investment strategy is in the best interest of a particular retail customer, and does not place the financial or other interest of the broker-dealer ahead of the interest of the retail customer, the broker-dealer would generally need to consider these specific product or strategy related factors, as relevant—and in particular the financial and other benefits to the broker-dealer—along with the customer's investment profile (as described below). While the Commission believes these are all important considerations in analyzing any recommendation made by a broker-dealer, they are critical considerations in analyzing whether a recommendation with respect to a particular retail customer's ''best interest.''

Under the existing ''customer specific suitability'' obligation, to determine whether an investment recommendation is suitable for the customer when evaluated in terms of the investor's financial situation, tolerance for risk, and investment objectives, broker-dealers have a duty to seek to obtain relevant information from customers relating to their financial situations and to keep such information current.[241]

The Commission also proposes to include this concept of a ''customer's investment profile,'' consistent with FINRA's suitability rule.[242] Specifically, the proposed rule would provide that the ''*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.'' [243] A broker-dealer would be required to exercise ''reasonable diligence'' to ascertain the retail customer's investment profile as part of satisfying proposed paragraph (a)(2)(i)(B).[244] When retail customer information is unavailable despite a broker-dealer's reasonable diligence to obtain such information, a broker-dealer would have to consider whether it has sufficient understanding of the retail customer to properly evaluate whether the recommendation is in the retail customer's best interest.[245] A broker-dealer that makes a recommendation to a retail customer for whom it lacks sufficient information to have a reasonable basis to believe that the recommendation is in the best interest of that retail customer based on the retail customer's investment profile would not meet its obligations under the proposed rule.[246]

For clarification, in keeping with the requirement that a securities-related recommendation must be in the best interest of the customer at the time it is made, a broker-dealer generally should make a reasonable effort to ascertain information regarding an existing customer's investment profile prior to the making of a recommendation on an ''as needed'' basis—*i.e.,* where a broker-dealer knows or has reason to believe that the customer's investment profile has changed.[247] The reasonableness of a

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Exchange Act Release No. 8662, at *7 (Aug. 6, 1969) (Commission opinion) (''It was incumbent on the salesmen in these circumstances, as part of their basic obligation to deal fairly with the investing public, to make only such recommendations as they had reasonable grounds to believe met the customers' expressed needs and objectives.''). Both courts and the Commission have found broker-dealers or their registered representatives liable for making unsuitable recommendations based on violations of the antifraud provisions of the federal securities laws. *See Brown* v. *E.F. Hutton Group,* 991 F.2d 1020, 1031 (2d Cir. 1993) (''[a]nalytically, an unsuitability claim is a subset of the ordinary Section 10(b) fraud claim''); *O'Connor* v. *R.F. Lafferty & Co.,* 965 F.2d 893 (10th Cir. 1992); *Clark* v. *John Lamula Investors, Inc.,* 583 F.2d 594, 599–600 (2d Cir. 1978); *Steven E. Louros* v. *Kreicas,* 367 F. Supp. 2d 572, 585 (S.D.N.Y. 2005); *Mauriber* v. *Shearson/American Express, Inc.,* 567 F. Supp. 1231 (S.D.N.Y 1983); *Steven E. Muth and Richard J. Rouse,* Exchange Act Release No. 52551, 58 SEC. 770 (Oct. 3, 2005) (Commission opinion). FINRA's suitability rule also imposes a customer-specific suitability obligation on broker-dealers. *See* FINRA Rule 2111.05(b) (''The customer-specific obligation requires that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile, as delineated in Rule 2111(a).'').

[240] *See supra* Section II.D.2.a (providing examples of various factors that could be considered when evaluating the risks and rewards of a recommended investment or investment strategy).

[241] *See Gerald M. Greenberg,* Exchange Act Release No. 6320, at *3, 40 SEC. 133, 137–38 (July 21, 1960) (Commission opinion, sustaining NASD findings) (holding that a broker-dealer cannot avoid the duty to make suitable recommendations simply by avoiding knowledge of the customer's financial situation). Under FINRA's suitability rule, the broker-dealer has a duty to undertake reasonable diligence to ascertain the customer's investment profile. FINRA Rule 2111(a) (''A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation.''); FINRA Regulatory Notice 12–25 at Q15–Q21 (discussing broker-dealer's information-gathering requirements).

[242] *Id.*

[243] *See* paragraph (c)(2) of Proposed Regulation Best Interest.

[244] *See* FINRA Regulatory Notice 12–25 at Q16 (outlining what constitutes ''reasonable diligence'' in attempting to obtain customer-specific information and that the reasonableness of the effort also will depend on the facts and circumstances). *See also* FINRA Regulatory Notice 11–25, Know Your Customer and Suitability (May 2011) (''FINRA Regulatory Notice 11–25'').

[245] *See* FINRA Regulatory Notice 11–25 at Q3. While ''neglect, refusal, or inability of the retail customer to provide or update any information'' would excuse the broker, dealer, or associated person from obtaining the information under proposed Rule 17a–3(a)(25) discussed in Section II.E., it would not relieve a broker-dealer of its obligation to determine whether it has sufficient information to properly evaluate whether a recommendation is in the retail customer's best interest.

[246] *See* FINRA Regulatory Notice 12–25 at Q16 (outlining what constitutes ''reasonable diligence'' in attempting to obtain customer-specific information and that the reasonableness of the effort also will depend on the facts and circumstances).

[247] We note that, pursuant to Exchange Act rules, a broker-dealer must submit to an existing customer

Continued

broker-dealer's effort to collect information regarding a customer's investment profile information depends on the facts and circumstances of a given situation, and the importance of each factor may vary depending on the facts and circumstances of the particular case.[248] Generally, however, absent information that would cause a broker-dealer to know or have reason to know that the information contained in a customer's investment profile is inaccurate, a broker-dealer may reasonably rely on the information in an existing customer's investment profile.

We believe our proposed definition of ''retail customer investment profile'' identifies appropriate factors that should be considered as part of evaluating a recommendation and whether it is in a retail customer's best interest, because the factors generally are relevant to a determination regarding whether a recommendation is in the best interest of a particular customer (*i.e.,* does the recommendation comport with the retail customer's investment profile). Furthermore, by applying a consistent definition across existing suitability requirements and proposed Regulation Best Interest, we hope to provide clarity to broker-dealers and maintain efficiencies for broker-dealers that have already established infrastructures to comply with their suitability obligations when making recommendations. Finally, we note that this definition would be consistent with the factors the DOL identified for consideration as part of a best interest recommendation under the BIC Exemption: ''the investment objectives, risk tolerance, financial circumstances and needs'' of a retirement investor.[249]

We propose to interpret the customer-specific obligation in paragraph (a)(2)(ii)(B) of proposed Regulation Best Interest consistent with existing precedent, rules and guidance, but subject to the enhanced ''best interest'' (rather than ''suitability'') standard. Thus, as noted above, when considering the factors that comprise a retail customer's investment profile, the broker-dealer would be required to consider whether it has sufficient information regarding the customer to properly evaluate whether a recommendation is in the best interest of the retail customer without placing the financial or other interest of the broker-dealer ahead of that particular retail customer's interests.[250] As such, the level of importance of each factor would depend on the facts and circumstances of a particular recommendation. One or more factors may have more or less relevance—or may not be obtained or analyzed at all—if the broker-dealer has a reasonable basis to believe that the factors are not relevant in light of the facts and circumstances of a particular situation.[251] For example, a broker-dealer may conclude that liquidity needs are irrelevant regarding all customers for whom only liquid securities will be recommended.[252]

We reiterate that we recognize that it may be consistent with a retail customer's investment objectives—and in many cases, in a retail customer's best interest—for a retail customer to allocate investments across a variety of investment products, or to invest in riskier or more costly products, such as some actively managed mutual funds, variable annuities, and structured products. However, in recommending such products, a broker-dealer must satisfy its obligations under proposed Regulation Best Interest. Such recommendations would continue to be evaluated under a fact specific analysis based on the security or investment strategy recommended in connection with the retail customer's investment profile, consistent with the proposed best interest obligation.

In addition, as discussed above under the proposed obligation in paragraph (a)(2)(ii)(A), we emphasize that the costs and financial incentives associated with a recommendation would generally be one of many important factors—including other factors such as the product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks and potential benefits, volatility and likely performance in a variety of market and economic conditions—to consider when determining whether a recommended security or investment strategy involving a security or securities is in the best interest of the retail customer.[253] Thus, where, for example, a broker-dealer is choosing among identical securities available to the broker-dealer, it would be inconsistent with the Care Obligation to recommend the more expensive alternative for the customer.[254] Similarly, we believe it would be inconsistent with the Care Obligation if the broker-dealer made the recommendation to a retail customer in order to: Maximize the broker-dealer's compensation (*e.g.,* commissions or other fees); further the broker-dealer's business relationships; satisfy firm sales quotas or other targets; or win a firm-sponsored sales contest.

We preliminarily believe that, under this prong of the Care Obligation, when a broker-dealer recommends a *more expensive* security or investment strategy over another reasonably available alternative offered by the broker-dealer, the broker-dealer would need to have a reasonable basis to believe that the higher cost is justified (and thus nevertheless is in the retail customer's best interest) based on other factors (*e.g.,* the product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks and potential benefits, volatility and likely performance in a variety of market and economic conditions), in light of the retail customer's investment profile. When a broker-dealer recommends a *more remunerative* security or investment strategy over another reasonably available alternative offered by the broker-dealer, the broker-dealer would need to have a reasonable basis to believe that—putting aside the broker-dealer's financial incentives—the recommendation was in the best interest of the retail customer based on the factors noted above, in light of the retail customer's investment profile. Nevertheless, this does not mean that a broker-dealer could not recommend the more remunerative of two reasonably available alternatives, if the broker-dealer determines the products are otherwise both in the best interest of—and there is no material difference between them from the perspective of—retail customer, in light of the retail customer's investment profile.

Furthermore, we do not believe a broker-dealer could meet its Care Obligation through disclosure alone. Thus, for example, where a broker-dealer is choosing among identical securities with different cost structures,

his or her account record or alternative document to explain any terms regarding investment objectives for accounts in which the member, broker or dealer has been required to make a suitability determination within the past 36 months. The account record or alternative document must include or be accompanied by prominent statements on which the customer should mark any corrections and return the account record or alternate document to the broker-dealer, and the customer should notify the broker-dealer of any future changes to information contained in the account record—including the customer's investment objectives. *See* CFR 240.17a–3(a)–17(i)(A), (B)(i), (B)(iii), (D). The accompanying discussion in the text addresses circumstances where a broker-dealer generally should make reasonable efforts to ascertain a customer's investment profile information prior to this 36-month period.

[248] *See* FINRA Regulatory Notice 12–25 at Q16.

[249] *See* Best Interest Contract Exemption, 81 FR 21002 (Apr. 8, 2016).

[250] *See* FINRA Rule 2111.04.

[251] *Id.*

[252] *See* FINRA Regulatory Notice 11–25 at Q3.

[253] *See* discussion *supra* Section II.D.

[254] *See supra* note 106, and accompanying text.

we believe it would be inconsistent with the best interest obligation for the broker-dealer to recommend the more expensive alternative for the customer, even if the broker-dealer had disclosed that the product was higher cost and had policies and procedures reasonably designed to mitigate the conflict under the Conflict of Interest Obligations, as the broker-dealer would not have complied with its Care Obligation.[255] Such a recommendation, disclosure aside, would still need to be in the best interest of a retail customer, and we do not believe it would be in the best interest of a retail customer to recommend a higher-cost product if all other factors are equal.

c. Reasonable Basis To Believe a Series of Recommended Transactions Is Not Excessive and Is in the Retail Customer's Best Interest

The third obligation would require a broker-dealer to exercise reasonable diligence, care, skill, and prudence to 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. The proposed requirement is intended to incorporate and enhance a broker-dealer's existing obligations under the federal securities laws and incorporate and go beyond FINRA's concept of ''quantitative suitability.'' We believe it is appropriate to incorporate this existing, well-established obligation, which would similarly promote consistency and clarity regarding this obligation. However, we believe it is appropriate to expand the scope of this requirement by applying it irrespective of whether a broker-dealer exercises actual or *de facto* control over a customer's account, thereby making the obligation consistent with the current requirements for ''reasonable basis suitability'' and ''customer specific suitability.'' Accordingly, Regulation Best Interest would include the existing ''quantitative suitability'' obligation, but without a ''control'' element.

Pursuant to the federal securities laws, broker-dealers can violate the federal antifraud provisions by engaging in excessive trading [256] that amounts to churning, switching, or unsuitable recommendations. Churning occurs when a broker-dealer, exercising control over the volume and frequency of trading in a customer account, abuses the customer's confidence for the broker-dealer's personal gain by initiating transactions that are excessive in view of the character of the account and the customer's investment objectives.[257] Switching occurs when a broker-dealer induces a customer to liquidate his or her shares in a mutual fund or annuity in order to purchase shares in another mutual fund or annuity, for the purpose of increasing the broker-dealer's compensation, where the benefit to the customer of the switch is not justified by the cost of switching.[258] The Commission has also found excessive trading as a suitability violation on the basis that ''the frequency of trading must also be suitable.'' [259] As noted above, FINRA's suitability rule also includes a similar concept known as quantitative suitability.[260]

Under the proposed rule, a broker-dealer must have a reasonable basis to believe that a series of recommended transactions is not excessive. Although no single test defines excessiveness, the following factors may provide a basis for determining that a series of recommended transactions is excessive: turnover rate,[261] cost-to-equity ratio,[262] and use of in-and-out trading [263] in a customer's account. Consideration of turnover rate, cost-to-equity ratio and use of in-and-out trading is consistent with some of the ways the Commission, the courts, and FINRA have historically

[255] *Id.*

[256] Excessive trading is a level of trading unjustified in light of the customer's investment objectives. *See Mihara* v. *Dean Witter & Co., Inc.,* 619 F.2d 814, 821 (9th Cir. 1980).

[257] *See Carras* v. *Burns,* 516 F.2d 251, 258 (4th Cir. 1975). The elements of a churning claim brought under the antifraud provisions include: (1)Eexcessive trading in the account that was unjustified in light of the customer's investment objectives; (2) the broker-dealer exercised actual or *de facto* control over the trading in the account; and (3) the broker-dealer acted with intent to defraud or with willful or reckless disregard for the customer's interests. *See Rizek* v. *SEC,* 215 F.3d 157, 162 (1st Cir. 2000). A broker-dealer churning a customer account may be liable under both Exchange Act Section 10(b) and Rule 10b–5 thereunder, and/or Exchange Act Section 15(c), Rules 15c1–2 and/or 15cl–7. *See, e.g., McNeal* v. *Paine, Webber, Jackson & Curtis, Inc.,* 598 F.2d 888, n.1 (2d Cir. 1979) (noting that churning is illegal under the Exchange Act Sections 15(c)(1) and 10(b) and Rule 10b–5).

[258] *See, e.g., Russell L. Irish,* 42 SEC. 735, 736–40 (1965), *aff'd, Irish* v. *SEC,* 367 F.2d 637 (9th Cir. 1966), *cert. denied,* 386 U.S. 911 (1967).

[259] *Edgar B. Alacan,* Exchange Act Release No. 49970, at *20, 57 SEC. 715, 736 (July 6, 2004) (Commission opinion) (quoting Sandra K. Simpson and Daphne Ann Pattee, Exchange Act Release No. 45923, at *13, 55 SEC. 766, 793–794 (May 14, 2002) (Commission opinion)). *See J. Stephen Stout,* Exchange Act Release No. 43410, at *13, 54 SEC. 888, 912 (Oct. 4, 2000) (Commission opinion) (finding turnover in customer account was unsuitable given customers' investment goals and needs).

[260] *See* FINRA Rule 2111.05(c) (''Quantitative suitability requires a member or associated person who has actual or *de facto* control over a customer account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule 2111(a).''). Unlike churning, a violation of quantitative suitability does not require a showing of wrongful intent. *See Cody* v. *SEC,* 693 F.3d 251, 260 (1st Cir. 2012) (''[W]hile subjective intent is relevant to churning charges under the antifraud regulation of Rule 10b–5, . . . NASD's suitability rule is violated when a representative engages in excessive trading relative to a customer's financial needs . . . regardless of motivation . . . .'').

[261] The turnover rate, which is the number of times during a given period that securities in an account are replaced by new securities, is a frequently used measure of excessive trading. Turnover rate is calculated by ''dividing the aggregate amount of purchases in an account by the average monthly investment. The average monthly investment is the cumulative total of the net investment in the account at the end of each month, exclusive of loans, divided by the number of months under consideration.'' *Shearson Lehman Hutton Inc.,* 49 SEC. 1119, 1122 n.10 (1989). Annual turnover rates as low as three may trigger liability for excessive trading. *See, e.g., Laurie Jones Canady,* 54 SEC. 65, 74 (1999), Exchange Act Release No. 41250 (Apr. 5, 1999) (annual turnover rates ranging from 3.83 to 7.28 times held excessive), *petition denied,* 230 F.3d 362 (DC Cir. 2000); *Donald A. Roche,* 53 SEC. 16, 22 (1997) (annual turnover rates of 3.3, 4.6, and 7.2 times held excessive); *Gerald E. Donnelly,* 52 SEC. 600, Exchange Act Release No. 36690 (Jan. 5, 1996) (annual turnover rates ranging from 3.1 to 3.8 times held excessive); *John M. Reynolds,* 50 SEC. 805 (1991) (annual turnover rate of 4.81 times held excessive). *See also Dep't of Enforcement* v. *Cody,* No. 2005003188901, 2010 FINRA Discip. LEXIS 8 (NAC May 10, 2010) (same), *aff'd,* Exchange Act Rel. No. 64565, 2011 SEC LEXIS 1862, at *48 (May 27, 2011) (finding turnover rate of three provided support for excessive trading); *Dep't of Enforcement* v. *Stein,* No. C07000003, 2001 NASD Discip. LEXIS 38, at *17 (NAC Dec. 3, 2001) (''Turnover rates between three and five have triggered liability for excessive trading''). The Commission has stated that, ''[a]lthough no turnover rate is universally recognized as determinative of churning, a rate in excess of 6 is generally presumed to reflect excessive trading,'' especially if the customer's objective is conservative. *Al Rizek,* 54 SEC. 261 (1999), Exchange Act Release No. 41725 (Aug. 11, 1999), *aff'd, Rizek* v. *SEC.,* 215 F.3d 157 (1st Cir. 2000). *See also Craighead* v. *E.F. Hutton & Co.,* 899 F.2d 485, 490 (6th Cir. 1990); *Arceneaux* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 767 F.2d 1498, 1502 (11th Cir. 1985).

[262] The cost-to-equity ratio represents ''the percentage of return on the customer's average net equity needed to pay broker-dealer commissions and other expenses.'' *Rafael Pinchas,* 54 SEC. 331, 340 (1999), 1999 SEC LEXIS 1754, at *18 (Commission review of NASD disciplinary proceeding). Cost-to-equity ratios as low as 8.7 have been considered indicative of excessive trading, and ratios above 12 generally are viewed as very strong evidence of excessive trading. *See Cody,* 2011 SEC LEXIS 1862, at *49 & *55 (finding cost-to-equity ratio of 8.7 percent excessive); *Thomas F. Bandyk,* Exchange Act Rel. No. 35415, 1995 SEC LEXIS 481, at *2–3 (Feb. 24, 1995) (''His excessive trading yielded an annualized commission to equity ratio ranging between 12.1% and 18.0%.'').

[263] In-and-out trading refers to the ''sale of all or part of a customer's portfolio, with the money reinvested in other securities, followed by the sale of the newly acquired securities.'' *Costello* v. *Oppenheimer & Co.,* 711 F.2d 1361, 1369 n.9 (7th Cir. 1983). A broker's use of in-and-out trading ordinarily is a strong indicator of excessive trading. *Id.*

evaluated whether trading activity is excessive.[264] These factors can be indicative of the magnitude of investor harm caused by the accumulation of high trading costs.

The proposed rule would enhance a broker-dealer's existing obligations in two ways. First, the proposed rule would create a new, explicit obligation under the Exchange Act that a broker-dealer have a reasonable basis to believe that a series of recommended transactions is not excessive and is in the retail customer's best interest when taken together. As noted, the Commission has found unsuitable recommendations of a series of transactions on the basis that the ''frequency of trading'' was not suitable.[265] Similarly, FINRA's quantitative suitability rule requires the broker-dealer to have a reasonable basis for believing that a series of recommended transactions is not excessive and *unsuitable* for the customer when taken together in light of the customer's investment profile.[266] The proposed rule, instead, would require a broker-dealer to have a reasonable basis to believe that a series of recommended transactions is not excessive and is in the retail customer's *best interest* when taken together in light of the retail customer's investment profile. What would constitute a ''series'' of recommended transactions would depend on the facts and circumstances. Notably, here this would mean a reasonable basis to believe that the series of recommended transactions is in the best interest of the retail customer based on factors other than the broker-dealer's financial incentive to recommend a series of transactions, as discussed above, and in light of the retail customer's investment profile, consistent with (a)(1).[267]

Second, the proposed rule would require a broker-dealer to have a reasonable basis to believe that a series of recommended transactions is not excessive and is in the retail customer's best interest, regardless of whether the broker-dealer has actual or *de facto* control over a retail customer account. Currently, to prove a churning claim under the antifraud provisions of the Exchange Act, courts and the Commission have interpreted the federal securities laws to require that the broker-dealer exercise actual or *de facto* control over a customer's account.[268] Similarly, FINRA's quantitative suitability rule only applies to a member or associated person who has actual or *de facto* control over a customer account.[269]

The Commission believes that a broker-dealer should 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, consistent with subparagraph(a)(1). We believe that imposing this requirement without a ''control'' element would provide consistency in the investor protections provided to retail customers by this proposed paragraph (a)(2)(ii)(C) by requiring a broker-dealer to always form a reasonable basis as to the recommended frequency of trading in a retail customer's account—irrespective of whether the broker-dealer ''controls'' or exercises ''*de facto* control'' over the retail customer's account. Moreover, it would also take a consistent approach with the other aspects of the proposed Care Obligation, which apply regardless of whether a broker-dealer ''controls'' or exercises ''*de facto* control'' over the retail customer's account. Finally, by removing the control element, the Commission believes the enhanced requirement generally should expand the scope of retail customers that could benefit from the protections of this requirement: specifically, protection from a broker-dealer recommending a level of trading that is so excessive that the resulting cost-to-equity ratio or turnover rate makes a positive return virtually impossible.[270] Thus, the fact that a customer may have *some* knowledge of financial markets or *some* ''control'' should not absolve the broker-dealer of its ultimate responsibility to have a reasonable basis for any recommendations that it makes.[271] We believe that when a broker-dealer is recommending a series of transactions to the retail customer the broker-dealer must, consistent with paragraph (a)(1), evaluate whether the series of recommendations is placing the broker-dealer's interests ahead of the retail customer's. Thus, even in instances where a broker-dealer would not be considered to ''control'' or exercise ''*de facto* control'' over the retail customer's account, the broker-dealer should be required to comply with proposed paragraph (a)(2)(ii)(C).

d. Consistency With Other Approaches

(1) DOL Fiduciary Rulemaking

By requiring a broker-dealer that is making a recommendation to a retail customer to act in the retail customer's best interest without placing the broker-dealer's interests ahead of the retail customer's interest, which is satisfied (in part) by the broker-dealer exercising ''reasonable diligence, care, skill, and prudence,'' we believe the proposed Care Obligation generally reflects similar underlying principles as the ''objective standards of care'' that are incorporated in the best interest Impartial Conduct Standard as set forth by the DOL in the BIC Exemption.[272]

As noted above, the DOL stated that the best interest Impartial Conduct Standard is intended to ''incorporate the objective standards of care and undivided loyalty,'' that require adherence to a professional standard of care in making investment recommendations that are in the investor's best interest, and not basing recommendations on the advice-giver's own financial interest in the transaction, nor recommending an investment unless it meets the objective prudent person standard of care.[273] Proof of fraud or misrepresentation is not required, and full disclosure is not a defense to making an imprudent recommendation or favoring one's own interest at the investor's expense.[274]

Focusing on the ''professional standard of care'' or ''duty of prudence,'' the DOL explains that the ''prudence'' standard, as incorporated in the ''best interest'' standard set forth in the BIC Exemption, is ''an objective standard of care that requires investment advice fiduciaries to investigate and evaluate

[264] *See also supra* notes 256, 257, 259, 261, 262, 263. *See, e.g.,* FINRA Regulatory Notice 12–25 at 14, 28–29.

[265] *See supra* note 259.

[266] *See supra* note 260.

[267] *See* discussion *supra* Section II.D.

[268] *See supra* note 257.

[269] *See supra* note 260.

[270] *See, e.g., In re Michael Bresner, et al.,* 2013 WL 5960690, at *112–115, ID-Rel. No. 517 (Nov. 8, 2013) (finding, *inter alia,* that some registered representatives did not churn certain customers' accounts because they did not exercise *de facto* control where one customer had declined recommendations ''a handful of times'' and another customer had picked stocks ''based on information he may have heard on the radio'' and made shadow trades of the same stocks that the representative had recommended).

[271] *See id.*

[272] The BIC Exemption requires that advice be in a retirement investor's best interest, and further defines advice to be in the ''best interest'' if the person providing the advice acts ''with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with the such matters would use . . . without regard to the financial or other interests'' of the person. BIC Exemption Section II(c)(1); Section VIII (d). The DOL stated this standard is based on longstanding concepts derived from ERISA and the law of trusts, and to ''require[s] fiduciaries to put the interests of trust beneficiaries first, without regard to the fiduciaries' own self-interest.'' BIC Exemption Release, 81 FR 21007, 21027.

[273] *Id.* at 21028.

[274] *Id.*

investments, make recommendations, and exercise sound judgment in the same way that knowledgeable and impartial professionals would.'' [275] The fiduciary must adhere to an objective professional standard and is subject to a particularly stringent standard of prudence when they have a conflict of interest.[276]

Our proposed Care Obligation establishes an objective, professional standard of conduct for broker-dealers that requires broker-dealers to ''exercise reasonable diligence, care, skill and prudence to'' understand the potential risks and rewards associated with their recommendation and have a reasonable basis to believe that it could be in the best interest of at least some retail customers, have a reasonable basis to believe that the recommendation is in a particular retail customer's best interest based on that retail customer's investment profile and the risks and rewards associated with the recommendation, and 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. Moreover, as noted above, this Care Obligation cannot be satisfied through full disclosure, and proof of fraud or misrepresentation would also not be required.

In addition, the Commission believes that the incorporation and enhancement of existing broker-dealer suitability obligations as part of the proposed care obligation would address many of the concerns that were raised by the DOL as a rationale for not referring to the existing FINRA suitability standard as the basis for the best interest obligation under the Impartial Conduct Standards.[277] The proposed Care Obligation incorporates and builds upon existing broker-dealer suitability obligations, as discussed above. Again, while not the only factors or sole determinants, cost and the broker-dealer's financial incentives would be important factors—of many, including the financial and other benefits to the broker-dealer—in determining whether a recommendation is in the best interest.[278] We preliminarily believe that, in order to meet its Care Obligation, when a broker-dealer recommends a security or investment strategy over another reasonably available alternative offered by the broker-dealer, the broker-dealer would need to have a reasonable belief that the recommendation was in the best interest of the retail customer based on such other factors, in light of the retail customer's investment profile. Furthermore, as discussed in the Conflict of Interest Obligations below, proposed Regulation Best Interest requires broker-dealers to take steps to eliminate or mitigate material conflicts of interest arising from financial incentives.

(2) 913 Study

Further, we believe that the proposed Care Obligation is also similar to the recommended duty of care in the 913 Study. As previously noted, the 913 Study recommended that the Commission engage in rulemaking and/or issue interpretive guidance on the components of the recommended uniform fiduciary standard: the duties of loyalty and care.[279] With respect to the duty of care, the 913 Study recommended that the Commission should consider specifying uniform standards for the duty of care owed to retail investors, through rulemaking and/or interpretive guidance. The 913 Study noted that minimum baseline professionalism standards could include, for example, specifying what basis a broker-dealer or investment adviser should have in making a recommendation to an investor (*i.e.,* suitability requirements).[280] Further, the 913 Study suggested that the Commission could articulate and harmonize any such professionalism standards for broker-dealers and investment advisers, by referring to and expanding upon, as appropriate, the explicit minimum standards of conduct relating to the duty of care currently applicable to broker-dealers (*e.g.,* suitability, best execution, and fair pricing and compensation requirements).[281] The 913 Study stated that the standards could also take into account Advisers Act principles related to the duty of care.[282]

As part of the proposed care obligation under Regulation Best Interest, we are only proposing an obligation with respect to the basis a broker-dealer must have in making a recommendation to a retail customer, and are not proposing the other aspects of the duty of care that are specified in the 913 Study—notably best execution and fair pricing and compensation requirements—as the Commission does not believe that it is necessary to do so at this time. As noted in the 913 Study,[283] broker-dealers currently are subject to explicit standards of conduct relating to best execution [284] and fair and reasonable compensation,[285] and preliminarily we do not believe that enhancements to these obligations are required in connection with this proposal.

Moreover, the 913 Study noted that the staff's recommendation to specify these aspects of the duty of care was partly based on the need to provide guidance to both investment advisers and broker-dealers of their obligations under the recommended uniform fiduciary duty.[286] In particular, the Study recognized that ''detailed guidance'' regarding the duty of care, and particularly the duty to provide suitable investment advice ''has not been a traditional focus of the investment adviser regulatory regime.'' [287] In a concurrent release, we are providing interpretive guidance that reaffirms—and in some cases clarifies—certain aspects of the fiduciary duty that an investment adviser owes to its

[275] BIC Exemption Release, 81 FR at 21028.

[276] *Id.*

[277] Although DOL did not specifically incorporate the suitability obligation as an element of the ''best interest'' standard, as suggested by FINRA, the DOL stated ''that many aspects of suitability are also elements of the Best Interest Standard'' and that a ''recommendation that is not suitable under the securities laws would not'' meet the standard. But, the DOL identified the following concerns with the current FINRA suitability standard: That it does not ''reference a best interest standard, clearly require brokers to put their client's interest ahead of their own, expressly prohibit the selection of the least suitable (but most remunerative) of available investments, or require them to take the kind of measures to avoid or mitigate conflicts of interest that are required as conditions of this exemption.'' BIC Exemption Release, 81 FR 21007, 21027–28.

[278] *See* discussion *infra* Section II.D.

[279] *See* 913 Study at 112.

[280] *Id.* at 123.

[281] *Id.* at 122.

[282] *Id.* at 123. *See also* Fiduciary Duty Interpretive Release, discussing, among other things, investment advisers' duty of care.

[283] *See* 913 Study at 121.

[284] Under the antifraud provisions of the federal securities laws and SRO rules, broker-dealers also have a legal duty to seek to obtain best execution of customer orders, which requires broker-dealers to seek to execute customers' trades at the most favorable terms reasonably available under the circumstances. *See, e.g., Newton* v. *Merrill, Lynch, Pierce, Fenner & Smith, Inc.,* 135 F.3d 266, 269–70 (3d Cir.), *cert. denied,* 525 U.S. 811 (1998); *Certain Market Making Activities on Nasdaq,* Exchange Act Release No. 40900 (Jan. 11, 1999) (citing *Sinclair* v. *SEC,* 444 F.2d 399 (2d. Cir. 1971); *Arleen W. Hughes,* Exchange Act Release No. 4048 (Feb. 18, 1948) (Commission Opinion), *aff'd sub nom. Hughes* v. *SEC,* 174 F.2d 969 (DC Cir. 1949). *See also* Order Execution Obligations, Exchange Act Release No. 37619A (Sept. 6, 1996) (''Order Handling Rules Release''). *See also* Regulation NMS, Exchange Act Release No. 51808 (June 9, 2005) (''Regulation NMS Release''); FINRA Rule 5310 (''Best Execution and Interpositioning'').

[285] FINRA Rule 2121 (''Fair Prices and Commissions'').

[286] *See* 913 Study at 122–23.

[287] *Id.* at 123.

clients.[288] As the proposed Regulation Best Interest is not based on the Advisers Act and would not apply to investment advisers, but rather is a new standard that would be unique to broker-dealers, taking into consideration the existing requirements of the broker-dealer regulatory regime, the Commission preliminarily does not believe that the Study's recommendations related to these other obligations are relevant here.

Although we are not proposing a fiduciary duty that includes a duty of care for broker-dealers, it is important to note that we believe that the proposed care obligation under Regulation Best Interest, in combination with existing broker-dealer obligations (such as best execution), is generally consistent with the underlying principles of—albeit more prescriptive than— the duty of care enforced under the Advisers Act. We believe any differences in the articulation of these standards for broker-dealers, as compared to investment advisers, is appropriate given differences in the structure and characteristics of their relationships with retail customers, to preserve and incorporate existing guidance and interpretations related to broker-dealer suitability obligations, and to provide clarity to how Regulation Best Interest would change existing obligations.

e. Request for Comment on Proposed Care Obligation

The Commission requests comment generally on the proposed care obligation. In addition, the Commission seeks comment on the following specific issues:

- Would the Care Obligation cause a broker-dealer to act in a manner that is consistent with what a retail customer would reasonably expect from someone who is required to act in their best interest? Why or why not?
- Under the Care Obligation, a broker-dealer must exercise reasonable diligence, care, skill, and prudence when making a recommendation, including assessing the potential risks and rewards associated with the recommendation. Do commenters believe that Regulation Best Interest is sufficiently clear that a broker-dealer and its associated natural persons may make a recommendation which may result in investor losses due to market or other risks inherent in investing?
- Has the Commission provided sufficient guidance on how a broker-dealer can satisfy each component of the Care Obligation?
- Do commenters believe the proposed Care Obligation enhances broker-dealers' existing suitability obligations?
- Are there aspects of a broker-dealer's existing suitability obligations that the Commission should not incorporate? Are there additional obligations that the Commission should incorporate? If so, which ones and why?
- As noted, the Commission is not proposing additional aspects of the duty of care that are specified in the 913 Study—notably best execution and fair pricing and compensation requirements, as broker-dealers are currently subject to explicit standards of conduct relating to best execution and fair and reasonable compensation. Do commenters agree that enhancements to these obligations are not required at this time? If not, please explain why.
- Is there sufficient clarity regarding how a broker-dealer ''exercises reasonable diligence, care, skill, and prudence''? In addition, is ''prudence'' a sufficiently clear term when referring to the broker-dealer's Care Obligation? Should the Commission consider another formulation for this obligation? If so, what language would be clearer?
- Is there sufficient clarity regarding how a broker-dealer determines if it has a reasonable basis to believe that the recommendation in the best interest of ''some'' retail customers in paragraph (a)(2)(ii)(A)? Why or why not? Should the rule expressly require a broker-dealer or associated person, in formulating this belief, to take into account all benefits to the broker-dealer or associated person from the recommendation and the costs to a hypothetical retail customer? Should the Commission require that a broker-dealer have a reasonable basis to believe that a recommendation is appropriate for the category of retail customers to which the retail customer belongs?
- Is there sufficient clarity regarding how a broker-dealer determines if it has a ''reasonable basis to believe that that the recommendation is the best interest of the retail customer based on the retail customer's investment profile and the potential risks and rewards associated with the recommendation'' in paragraph (a)(2)(i)(B)? Why or why not? Should the rule expressly require a broker-dealer or associated person, in formulating this belief, to take into account all benefits to the broker-dealer or associated person from the recommendation and the costs to the retail customer?
- Should the Commission take a different approach to defining the Care Obligation? If so, what approach should the Commission and take and why? For example, in lieu of establishing a Care Obligation that requires recommendations in the ''best interest,'' as described, should the Care Obligation codify existing suitability obligations and require certain additional obligations (such as not placing the financial or other interest of the broker-dealer ahead of the retail customer)? If so, what additional obligations should be required and why?
- As noted above, the Commission preliminary believes it is appropriate to incorporate the concept of a ''customer's investment profile'' consistent with FINRA's suitability rule. Do commenters agree? Why or why not? Should additional factors be considered?
- Should the Commission require broker-dealers to document their efforts to collect investment profile information? Relatedly, should broker-dealers be required to document why they believe one or more factors in a customer's investment profile are not relevant to a determination regarding whether a recommendation is in the best interest for a particular customer? Why or why not?
- Should the interpretation of what it means to make a recommendation in the ''best interest'' for purpose of paragraph (a)(2)(i)(B) be different from the interpretation of the best interest obligation under paragraph (a)(1)? Why or why not? Please be specific regarding any alternative suggestions and what they would or would not require. If the standard were different, should the Commission change the provision in the proposed rule that the obligation under paragraph (a)(1) is satisfied only by compliance with the elements of paragraph (a)(2)? If so, should the obligation in paragraph (a)(1) be an independent obligation, for violation of which a broker-dealer and associated person could be liable even if they complied with the elements of paragraph (a)(2)?
- Should a broker-dealer and its associated persons, when considering similar investment options available through the broker-dealer, have the obligation to recommend the least expensive and/or least remunerative option, at least if all other relevant factors are equal? Why or why not? What other factors should be relevant in such consideration?
- Should a broker-dealer and its associated persons, when considering investment options, only be required to consider options available through the broker-dealer? Alternatively, if a broker-dealer and its associated persons are required to consider additional options outside the broker-dealer, how should the Commission articulate the extent of this duty? Please be specific.

[288] *See* Fiduciary Duty Interpretive Release.

• Is the phrase ''reasonably available alternative'' sufficiently clear? Should the Commission specify certain factors to be used in the determination? Is there an alternative phrase or term that would be clearer? Please be specific.

• Is there sufficient clarity regarding what ''less expensive'' or ''least remunerative'' means and under what circumstances expense or remuneration should be a significant factor?

• Should the Commission define what ''best interest'' means for purposes of paragraph (a)(2)(i)(B)?

• Do commenters agree that turnover rate, cost-to-equity ratio and in-and-out-trading are relevant factors for determining that a series of recommended transactions is excessive for purposes of paragraph (a)(2)(i)(C)? If not, what factors should a broker-dealer consider with respect to this proposed obligation? Should the Commission expressly articulate the relevant factors as part of the rule?

• The Commission is proposing to use the term ''series of recommended transactions'' as part of the obligation in paragraph (a)(2)(i)(C), which is based, in part, on FINRA's quantitative suitability obligation. Is ''series of recommended transactions'' a sufficiently clear term when referring to the quantity/frequency of trades? Should the Commission consider another formulation for this obligation? If so, what language would be clearer?

• As noted above, the best interest obligation would not extend beyond a particular recommendation or generally require a broker-dealer to have a continuing duty to a retail customer. Is there sufficient clarity regarding how the obligation applies to a series of recommended transactions? Why or why not?

• The Commission is proposing, as part of the obligation in paragraph (a)(2)(i)(C), that a broker-dealer must have a reasonable basis to believe that a series of recommended transactions is *not excessive* and is *in the retail customer's best interest.* Should the Commission consider requiring only a reasonable basis to believe that a ''series of recommended transactions'' (or such other term per the preceding question) is *not excessive,* or in the alternative, only requiring a reasonable basis to believe that a series of recommended transactions (or such other term per the preceding question) is *in the retail customer's best interest*? If so, why?

• As noted above, FINRA's quantitative suitability rule requires a broker-dealer to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, are *not excessive and unsuitable* for the customer when taken together in light of the customer's investment profile. The Commission's proposed obligation, instead, would require a broker-dealer to have a reasonable basis to believe that a series of recommended transactions is not excessive and *is in the retail customer's best interest.* Should the Commission consider different language, for example, requiring a reasonable basis to believe that a series of recommended transactions is not excessive *and not contrary* to the retail customer's best interest? Why or why not?

• The Commission is not proposing to incorporate the element of control or *de facto* control in the requirement that a broker-dealer form a reasonable basis to believe that a series of recommended transactions, even if in the best interest of the retail customer 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. Should the Commission require ''control'' or ''*de facto*'' control? Why or why not?

3. Conflict of Interest Obligations

The Commission is proposing two requirements under Regulation Best Interest focused specifically on the treatment of conflicts of interest. These Conflict of Interest Obligations would require a broker-dealer entity [289] to: (1) Establish, maintain, and enforce written policies and procedures reasonably designed to identify, and disclose, or eliminate, all material conflicts of interest that are associated with recommendations covered by Regulation Best Interest; and (2) establish, maintain, and enforce written policies and procedures reasonably designed to identify, and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.

We believe that requiring the establishment of such policies and procedures is critical to identifying and addressing conflicts of interest, whether through elimination or, at a minimum, disclosure (and mitigation, in the case of financial incentives). We also believe that policies and procedures help ensure compliance with the proposed requirement to disclose any material conflicts of interest associated with a broker-dealer's recommendations pursuant to the Disclosure Obligation described above. We further believe that requiring the establishment of such policies and procedures serves the Commission's goal of facilitating the disclosure and mitigation of material conflicts of interest, while minimizing additional compliance costs that may be passed on to retail customers.

Under the proposed rule, broker-dealers would be permitted to exercise their judgment as to whether, for example, the conflict can be effectively disclosed (as discussed in Disclosure Obligation), determine what conflict mitigation methods may be appropriate, and determine whether or how to eliminate a conflict, if necessary, so long as the broker-dealer's policies and procedures are reasonably designed. Whether a broker-dealer's policies and procedures are reasonably designed to meet its Conflict of Interest Obligations will depend on the facts and circumstances of a given situation. The Commission also believes requiring policies and procedures specifically aimed at mitigating, in addition to disclosing, material conflicts of interest arising from financial incentives provides enhanced protections not available to retail customers through disclosure alone.

A broker-dealer would not comply with the Conflict of Interest Obligations of Regulation Best Interest by simply creating policies and procedures, if the broker-dealer does not maintain and enforce such policies and procedures.[290] Broker-dealers are already subject both to liability for failure to supervise under Section 15(b)(4)(E) [291] of the Exchange Act and to express supervision requirements under SRO rules, including the establishment of policies

[289] Unlike the Disclosure and Care Obligations, which apply to a broker or dealer and to natural persons who are associated persons of a broker or dealer, the proposed Conflict of Interest Obligations apply solely to the broker or dealer entity, and not to the natural persons who are associated persons of a broker or dealer. For purposes of discussing the Conflict of Interest Obligations, the term ''broker-dealer'' refers only to the broker-dealer entity, and not to such individuals. While the Conflict of Interest Obligation applies only to the broker-dealer entity, the conflicts of interest that the broker-dealer entity must analyze are between: (i) The broker-dealer entity and the retail customer, (ii) the natural persons who are associated persons and the retail customer, and (iii) the broker-dealer entity and the natural persons who are associated persons (if the retail customer is indirectly impacted).

[290] In the 913 Study, the staff stated that policies and procedures alone are not sufficient to discharge supervisory responsibility; it is also necessary to implement measures to monitor compliance with those policies and procedures. *See* 913 Study at 74, (citing *In re Application of Stuart K. Patrick,* Exchange Act Release No. 32314 (May 17, 1993); *In re Application of Richard F. Kresge,* Exchange Act Release No. 55988 (June 29, 2007) (demonstrating the Commission's approach over the years)).

[291] *See* Section 15(b)(4)(E) of the Exchange Act (authorizing the Commission to impose sanctions on a firm or any associated person that fails reasonably to supervise another person subject to its supervision that commits a violation of the federal securities laws).

and procedures reasonably designed to prevent and detect violations of, and to achieve compliance with, the federal securities laws and regulations, as well as applicable SRO rules.[292] As such, we believe that a broker-dealer could comply with the policies and procedures requirement of Regulation Best Interest by adjusting its current systems of supervision and compliance, as opposed to creating new systems.

a. Material Conflicts of Interest and Material Conflicts of Interest Arising From Financial Incentives Associated With Such Recommendations

As noted in the discussion of the Disclosure Obligation in Section II.D.1., we propose to interpret, for purposes of Regulation Best Interest, a ''material conflict of interest'' as a conflict of interest that a reasonable person would expect might incline a broker-dealer—consciously or unconsciously—to make a recommendation that is not disinterested.[293]

For purposes of the Conflict of Interest Obligation in paragraph (a)(2)(iv), we preliminarily believe that material conflicts of interest arising from ''financial incentives'' associated with a recommendation generally would include, but are not limited to, compensation practices established by the broker-dealer, including fees and other charges for the services provided and products sold; employee compensation or employment incentives (*e.g.,* quotas, bonuses, sales contests, special awards, differential or variable compensation, incentives tied to appraisals or performance reviews); compensation practices involving third-parties, including both sales compensation and compensation that does not result from sales activity, such as compensation for services provided to third-parties (*e.g.,* sub-accounting or administrative services provided to a mutual fund); receipt of commissions or sales charges, or other fees or financial incentives, or differential or variable compensation, whether paid by the retail customer or a third-party; sales of proprietary products or services, or products of affiliates; and transactions that would be effected by the broker-dealer (or an affiliate thereof) in a principal capacity.

While our interpretation of the types of material conflicts of interest arising from financial incentives is broad, we do not intend to require broker-dealers to mitigate every material conflict of interest in order to satisfy their Conflict of Interest Obligations. We request comment below on the scope of the term financial incentives, whether we have appropriately identified the types of financial incentives that should be eliminated or mitigated and disclosed, whether there are other material conflicts of interest commenters believe are more appropriately eliminated or mitigated and disclosed, and whether there are certain financial incentives that are appropriately addressed through disclosure and for which additional mitigation is unnecessary or that the burden of mitigating the conflict would not justify any associated benefit to retail customers.

The Commission's proposed Conflict of Interest Obligations are limited to material conflicts of interest, and to material conflicts arising from financial incentives, that are *associated with a recommendation.* The Commission believes this limitation is appropriate because broker-dealers often provide a range of services as part of any relationship with a retail customer, many of which would not involve a recommendation, and such services already are subject to general antifraud liability and specific requirements to address associated conflicts of interest.[294] We are not proposing to change the disclosure obligations associated with these services under the general antifraud provisions of the federal securities laws.

b. Reasonably Designed Policies and Procedures

In determining whether a broker-dealer ''establishes, maintains, and enforces reasonably designed policies and procedures,'' to address its material conflicts of interest, as required by the Conflict of Interest Obligations, the Commission preliminarily believes it would consider whether a broker-dealer has adequate compliance and supervisory policies and procedures in place (as well as a system for applying such procedures) to identify and at a minimum disclose (and mitigate, in the case of financial incentives) or eliminate, material conflicts of interest. We believe that there is no one-size-fits-all framework, and broker-dealers should have flexibility to tailor the policies and procedures to account for, among other things, business practices, size and complexity of the broker-dealer, range of services and products offered and associated conflicts presented.

We believe that it would be reasonable for broker-dealers to use a risk-based compliance and supervisory system to promote compliance with Regulation Best Interest, rather than conducting a detailed review of each recommendation of a securities transaction or security-related investment strategy to a retail customer.[295] Use of a risk-based compliance and supervisory system would grant broker-dealers the flexibility to establish systems that are tailored to their business models, and to focus on specific areas of their business that pose the greatest risk of noncompliance with the Conflict of Interest Obligations,[296] as well as the greatest risk of potential harm to retail customers through such noncompliance. We believe that this would protect retail customers by focusing the broker-dealer's resources on the areas of greatest risk to both the firm and the retail customer, as opposed to focusing on every aspect of the broker-dealer's business, regardless of the level of risk of noncompliance or harm.

Among the components that broker-dealers should consider including in their programs are: Policies and procedures outlining how the firm identifies its material conflicts (and material conflicts arising from financial incentives), including such material conflicts of natural persons associated with the broker-dealer, clearly identifying all such material conflicts of interest and specifying how the broker-dealer intends to address each conflict; robust compliance review and monitoring systems; processes to escalate identified instances of

[292] *See* FINRA Rule 3110 (Supervision) (requiring firms to establish and maintain systems to supervise the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules).

[293] *See* Section II.D.I.b.

[294] *See supra* notes 87, 175, 176, 177 and accompanying text.

[295] We propose to interpret the term ''risk-based'' consistent with SRO rules so that broker-dealers can incorporate these new obligations into their current compliance infrastructure. According to FINRA, ''the term 'risk based' describes the type of methodology a firm may use to identify and prioritize for review those areas that pose the greatest risk of potential securities law and self-regulatory organization (SRO) rule violations. In this regard, a firm is not required to conduct detailed reviews of each transaction if the firm is using a reasonably designed risk-based review system that provides the firm with sufficient information to enable the firm to focus on the areas that pose the greatest numbers of and risks of violation.'' *See* FINRA Regulatory Notice 14–10, Consolidated Supervision Rules (Mar. 2014).

[296] As previously noted, the Commission would expect smaller investment advisers without conflicting business interests to require much simpler policies and procedures than larger firms that, for example, have multiple potential conflicts as a result of their other lines of business or their affiliations with other financial service firms. *See, e.g.,* Compliance Programs of Investment Companies and Investment Advisers, Advisers Act Release No. 2204 (Dec. 17, 2003) (''Advisers Act Release 2204'').

noncompliance to appropriate personnel for remediation; procedures that clearly designate responsibility to business lines personnel for supervision of functions and persons,[297] including determination of compensation;[298] processes for escalating conflicts of interest; processes for a periodic review and testing of the adequacy and effectiveness of policies and procedures;[299] and training on the policies and procedures.[300]

c. Identifying Material Conflicts of Interest

We believe that having a process to identify and appropriately categorize such conflicts of interest is a critical first step in helping to ensure that broker-dealers have reasonably designed policies and procedures to eliminate, or at a minimum disclose (and mitigate, as required) their material conflicts of interest. Reasonably designed policies and procedures to identify material conflicts of interest (including material conflicts arising from financial incentives) generally should do the following:

(i) Define such material conflicts in a manner that is relevant to a broker-dealer's business (*i.e.,* material conflicts of both the broker-dealer entity and natural persons who are associated persons of the broker-dealer), and in a way that enables employees to understand and identify conflicts of interest;

(ii) establish a structure for identifying the types of material conflicts that the broker-dealer (and natural persons who are associated persons of the broker-dealer) may face, and whether such conflicts arise from financial incentives;

(iii) establish a structure to identify conflicts in the broker-dealer's business as it evolves;

(iv) provide for an ongoing (*e.g.,* based on changes in the broker-dealer's business or organizational structure, changes in compensation incentive structures, and introduction of new products[301] or services) and regular, periodic (*e.g.,* annual) review for the identification of conflicts associated with the broker-dealer's business; and

(v) establish training procedures regarding the broker-dealer's material conflicts of interest, including material conflicts of natural persons who are associated persons of the broker-dealer, how to identify such material conflicts of interest (and material conflicts arising from financial incentives), as well as defining employees' roles and responsibilities with respect to identifying such material conflicts of interest.

d. Disclosure, or Elimination, of Material Conflicts of Interest and Disclosure and Mitigation, or Elimination, of Material Conflicts of Interest Arising From Financial Incentives Associated With a Recommendation

In addition to identifying material conflicts of interest, the Commission proposes to require that the policies and procedures be reasonably designed to at a minimum disclose, or eliminate, all material conflicts of interest associated with making recommendations to retail customers. In addition to the general guidance regarding reasonably designed policies and procedures outlined above, we believe that reasonably designed policies and procedures generally should establish a clearly defined and articulated structure for: Determining how to effectively address material conflicts of interest identified (*i.e.,* whether to eliminate or disclose (and mitigate, as required) the material conflict); and setting forth a process to help ensure that material conflicts are effectively addressed as required by the policies and procedures.

If a broker-dealer determines to satisfy its obligation to address material conflicts of interest through disclosure, the broker-dealer should consider the preliminary guidance on aspects of effective disclosure, as discussed above in the Disclosure Obligation.[302]

While the Conflict of Interest Obligations would require a broker-dealer to have policies and procedures reasonably designed to at a minimum disclose or eliminate all material conflicts of interest related to the recommendation (or to disclose and mitigate or eliminate those material conflicts of interest arising from financial incentives), it does not mandate the absolute elimination of any particular conflicts, absent another requirement to do so. The absolute elimination of some particular conflicts could mean a broker-dealer may not receive compensation for its services, which is not the Commission's intent.

A broker-dealer seeking to address its Conflict of Interest Obligations through elimination of a material conflict of interest could choose to eliminate the conflict of interest entirely, for example, by removing incentives associated with a particular product or practice or not offering products with special incentives. Alternatively, a broker-dealer could satisfy this obligation by negating the effect of the conflict by, for example, in the case of conflicts related to affiliated mutual funds, crediting fund advisory fees against other broker-dealer charges—thus effectively eliminating the material conflict of interest.

Furthermore, although the Commission is not proposing to require a broker-dealer to develop policies and procedures to both disclose and mitigate *all* material conflicts of interest (outside of the material conflicts arising from financial incentives, which would specifically require mitigation), the proposed Conflict of Interest Obligations would require that a broker-dealer develop policies and procedures reasonably designed to ''*at a minimum disclose,* or eliminate'' all material conflicts. As such, a broker-dealer may determine to design its policies and procedures to address material conflicts of interest by both disclosing a conflict and taking other additional steps to mitigate the conflict (outside of the material conflicts arising from financial incentives, which would specifically require mitigation). However, in situations where the broker-dealer determines that disclosure does not reasonably address the conflict, for example, where the disclosure cannot be made in a simple or clear manner, or otherwise does not help the retail customer's understanding of the conflict or capacity for informed decision-making, or where the conflict is such

[297] *See Frequently Asked Questions about Liability of Compliance and Legal Personnel at Broker-Dealers under Sections 15(b)(4) and 15(b)(6) of the Exchange Act,* Division of Trading and Markets (Sept. 30, 2013), *available at https://www.sec.gov/divisions/marketreg/faq-cco-supervision-093013.htm* (providing guidance on the roles and duties of compliance and legal personnel at broker-dealers).

[298] The Commission believes that the ability to control the compensation of registered representatives is a key mechanism by which registered broker-dealers exercise supervisory controls.

[299] *See* Advisers Act Release 2204; *see also Staff Questions Advisers Should Ask While Establishing or Reviewing Their Compliance Programs* (May 2006), *available at https://www.sec.gov/info/cco/adviser_compliance_questions.htm.*

[300] *Id.*

[301] FINRA Conflicts Report at 3 (''Firms at the forefront of financial innovation are in the best position, and are uniquely obligated, to identify the conflicts of interest that may exist at a product's inception or that develop over time. There are a number of effective practices firms can adopt to address such conflicts. First, firms can use a new product review process—typically through new product review committees—that includes a mandate to identify and mitigate conflicts that a product may present. Second, firms should disclose those conflicts in plain English, with the objective of helping ensure that customers comprehend the conflicts that a firm or registered representative have in recommending a product. These conflicts may be particularly acute where complex financial products are sold to less knowledgeable investors, including retail investors.'')

[302] *See* Section II.D.1.

that it may be difficult for the broker-dealer to determine that it is not putting its own interest ahead of the retail customer's interest, under the proposed obligation to have reasonably designed policies and procedures to ''at a minimum disclose, or eliminate'' all material conflicts the broker-dealer would need to establish policies and procedures reasonably designed to either eliminate the conflict or to both disclose and mitigate the conflict.

e. Mitigation of Material Conflicts of Interest Arising From Financial Incentives

Under the requirement relating to the treatment of conflicts of interest arising from financial incentives, the Commission proposes to require broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives. This proposed requirement is intended to capture the range of financial incentives that could pose a material conflict of interest.

The Commission recognizes the importance of the brokerage model as a potentially cost-effective (and sometimes, a less costly) option for investors to pay for investment advice. As discussed above, the Commission recognizes, however, that broker-dealer financial incentives—including internal compensation structures and compensation arrangements [303] with third parties—create inherent conflicts that may affect the impartiality of a recommendation.[304] These financial incentives can create conflicts of interest that may be difficult, if not impossible, to effectively manage through disclosure alone, or to eliminate.[305] At the same time, the Commission, like other regulators,[306] recognizes that differential compensation may appropriately recognize the time and expertise necessary to understand an investment, and in doing so promote investor choice and access to a range of products, and so elimination of the conflict may not be appropriate or desirable.[307]

In addition, through the proposed requirement to develop policies and procedures reasonably designed to mitigate conflicts of interest arising from financial incentives, we are clarifying how the best interest obligation would be fulfilled when a broker-dealer is engaging in principal trading by requiring a broker-dealer to, through its required policies and procedures, identify and address, the financial incentives presented by principal trading.[308]

Accordingly, to make sure that recommendations are in the best interest of the retail customer, the Commission proposes requiring broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed to identify and disclose *and* mitigate material conflict of interests related to financial incentives, in addition to the proposed requirement to establish, maintain and enforce written policies and procedures reasonably designed to identify and disclose or eliminate general material conflicts of interest in paragraph (a)(2)(iii).

As noted above, in lieu of mandating specific mitigation measures or a ''one-size fits all'' approach, the Commission's proposal would leave broker-dealers with flexibility to develop and tailor reasonably designed policies and procedures that include conflict mitigation measures, based on each firm's circumstances.[309] This principles-based approach provides broker-dealers the flexibility to establish their supervisory system in a manner that reflects their business models, and based on those models, focus on areas where heightened concern may be warranted.[310] The Commission believes that reasonably designed policies and procedures should include mitigation measures that depend on a variety of factors related to a broker-dealer's business model (such as the size of the broker-dealer, retail customer base, the nature and significance of the compensation conflict, and the complexity of the product), some of which may be weighed more heavily than others.[311] Depending on a broker-dealer's assessment of these factors as a whole, more or less demanding mitigation measures included in reasonably designed policies and procedures may be appropriate. For example, heightened mitigation measures, including enhanced supervision, may be appropriate in situations where the retail customer displays a less sophisticated understanding of securities investing

[303] Conflicts of interest may arise from compensation other than sales compensation. For example, in the case of mutual funds, compensation for account servicing, sub-transfer agency, sub-accounting, recordkeeping or other administrative services provides an incentive for a firm to offer the mutual funds from or for which the firm receives such compensation and not offer other funds or products from or for which it does not receive such compensation.

[304] *See* Tully Report. The Commission has historically expressed concerns about the financial incentives that commission-based compensation provides to broker-dealers. In order to address these concerns and preserve the broker-dealer model to promote investor choice, Regulation Best Interest imposes the additional requirement to mitigate conflicts related to financial incentives. *See supra* Section I.A.

[305] Several commenters in response to Chairman Clayton's Statement expressed similar concerns regarding the limits of disclosure to address broker-dealer conflicts, and supported requiring both disclosure and mitigation of conflicts. *See, e.g.,* Economic Policy Institute Letter; PIABA Letter; Financial Planning Coalition Letter (''The Coalition believes that disclosures alone are insufficient to remedy investor confusion and harm stemming from conflicted advice. Although the Coalition agrees that disclosures can be a useful and important tool for investors, relying solely on disclosures is inconsistent with the SEC's mission of investor protection and contradicts substantial prior research demonstrating that disclosures alone are ineffective. The Coalition opposes a disclosure-only regime and urges consideration of system based on either conflict avoidance or disclosures *coupled with* proper mitigation.''); Nationwide Letter (''. . . Nationwide is firmly committed to supporting a new best interest standard of care for broker-dealers that focuses on increased transparency and mitigation of conflicts, while at the same time protecting consumers' access to advice, choice, and affordable products.''); LPL Financial Letter (recommending that the Commission consider adopting a standard of conduct that preserves financial institutions' flexibility to avoid or manage conflicts in which they have a competing financial interest, provided they fully and fairly disclose the nature of such conflicts to investors and take such additional steps as may be necessary to ensure such conflicts do not adversely affect the impartiality and prudence of the advice they provide to investors).

[306] For example, the preamble to the BIC Exemption states ''The Department has not made the requirements more stringent, as suggested by some commenters, so as to require completely level compensation. Different payments for different classes of investments may be appropriate based on differences in the time and expertise necessary to recommend them'' and that under the BIC Exemption ''differential compensation is permitted but only if the Financial Institution's policies and procedures, as a whole are reasonably designed to avoid a misalignment of interests between Advisers and Retirement Investors'' and that ''the payment of differential compensation should be based only on neutral factors.'' BIC Exemption Release, FR 21007, 21035–40.

[307] *See, e.g.,* Letter from James D. Gallagher, Executive Vice President and General Counsel, John Hancock Life Insurance Company (U.S.A.) *(Aug. 25, 2017)* (''John Hancock Letter'') (''Customer choice should allow advisers and broker-dealers to direct clients to products that suit their needs, whether or not those products are proprietary.'').

[308] This is in line with the 913 Study recommendation that the Commission address how the uniform fiduciary standard of conduct would be fulfilled when engaging in principal trading, which at a minimum should require disclosure but not necessarily require the specific procedures of Advisers Act Section 206(3). *See* Study at 113.

[309] FINRA observed that the appropriate framework for developing a conflicts governance framework depends on the scope and scale of a firm's business. *See* FINRA Conflicts Report. *See also* Letter from David T. Bellaire, Esq., Executive Vice President and General Counsel, Financial Services Institute (Oct. 30, 2017) (''FSI Letter'') (recommending the Commission adopt a principles-based approach to allow firms to tailor their policies and procedures designed to identify, manage and mitigate conflicts to their unique business models).

[310] *See* FINRA Rule 3110(b)(1) (Supervision) and Section 15(b)(4)(E) of the Exchange Act.

[311] *See* FINRA Conflicts Report.

generally [312] or the conflicts associated with particular products involved,[313] where the compensation is less transparent (for example, a payment received from a third-party or built into the price of the product or a transaction versus a straight commission payment), or depending on the complexity of the product.[314] A broker-dealer could reasonably determine through its policies and procedures that the same mitigation measures could apply to a particular type of retail customer, type of product or type of compensation conflict across the board; or in some instances a broker-dealer may reasonably determine that some compensation conflicts may be more difficult to mitigate, and are more appropriately avoided in their entirety or for certain categories of retail customers. Policies and procedures may be reasonably designed at the outset, but may later become unreasonable based on subsequent events or information obtained, such that the actual experience of a broker-dealer should be used to revise the broker-dealer's measures as appropriate. Further, what are considered reasonable mitigation measures for a small firm may be different than that for a large firm.[315] While many broker-dealers may have programs currently in place to manage conflicts of interest, each broker-dealer will need to carefully consider whether its existing framework complies with the proposed obligations under Regulation Best Interest.

For example, broker-dealers generally should consider incorporating the following non-exhaustive list of potential practices [316] as relevant into their policies and procedures to promote compliance with (a)(2)(iv) of proposed Regulation Best Interest [317]:

- Avoiding compensation thresholds that disproportionately increase compensation through incremental increases in sales;
- minimizing compensation incentives for employees to favor one type of product over another, proprietary or preferred provider products, or comparable products sold on a principal basis—for example, establishing differential compensation criteria based on neutral factors (*e.g.,* the time and complexity of the work involved);
- eliminating compensation incentives within comparable product lines (*e.g.,* one mutual fund over a comparable fund) by, for example, capping the credit that a registered representative may receive across comparable mutual funds or other comparable products across providers;
- implementing supervisory procedures to monitor recommendations that are: Near compensation thresholds; near thresholds for firm recognition; involve higher compensating products, proprietary products or transactions in a principal capacity; or, involve the rollover or transfer of assets from one type of account to another (such as recommendations to rollover or transfer assets in an ERISA account to an IRA, when the recommendation involves a securities transaction) [318] or from one product class to another [319];
- adjusting compensation for registered representatives who fail to adequately manage conflicts of interest; and
- limiting the types of retail customers to whom a product, transaction or strategy may be recommended (*e.g.,* certain products with conflicts of interest associated with complex compensation structures).

In addition, we believe certain material conflicts of interest arising from financial incentives may be more difficult to mitigate,[320] and may be more appropriately avoided in their entirety for retail customers or for certain categories of retail customers (*e.g.,* less sophisticated retail customers). These practices may include the payment or receipt of certain non-cash compensation that presents conflicts of interest for broker-dealers, for example, sales contests, trips, prizes, and other similar bonuses that are based on sales of certain securities or accumulation of

[312] We believe that broker-dealers would ordinarily obtain, pursuant to the proposed Care Obligation, sufficient facts concerning a retail customer to determine a retail investor's understanding of securities investing. As part of evaluating a recommendation and whether it is in a retail customer's best interest, the Care Obligation requires a broker-dealer to make a reasonable effort to ascertain information regarding an existing customer's investment profile, including, 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. *See* paragraph (c)(2) of Proposed Regulation Best Interest (defining ''Retail Customer Investment Profile'').

[313] Currently, FINRA's heightened suitability requirements for options trading accounts require that a registered representative have ''a reasonable basis for believing, at the time of making the recommendation, that the customer has such knowledge and experience in financial matters that he may reasonably be expected to be capable of evaluating the risks of the recommended transaction, and is financially able to bear the risks of the recommended position in the complex product.'' FINRA Rule 2360(b)(19). FINRA has encouraged member firms to take a similar approach in recommending complex products. FINRA has noted that certain heightened procedures firms have taken include making approval of complex products contingent upon specific limitations or conditions, and prohibiting their sales force from recommending the purchase of some complex products to certain retail investors. *See* FINRA Regulatory Notice 12–03, Heightened Supervision of Complex Products (Jan. 2012).

[314] In a recent FINRA examination report, FINRA noted that the concerns that FINRA had during the course of examinations with regard to the suitability of certain products and their supervision did not vary materially by firm size, but did occur more frequently in connection with certain product classes, specifically unit investment trusts (''UITs'') and certain multi-share class and complex products, such as leveraged and inverse exchange-traded funds (''ETFs''). *See* Report on FINRA Examination Findings (Dec. 2017), *available at http://www.finra.org/industry/2017-report-exam-findings* (''FINRA Exam Report 2017'').

[315] Large firms may address conflicts of interest through enterprise management or operational risk frameworks, and components of such programs, for example, risk and control self-assessments, may provide an opportunity to identify and evaluate possible impacts. By contrast, small firms selling basic products may have a conflicts management framework that relies largely on the tone set by the firm owner coupled with required supervisory controls, particularly related to suitability, and the firm's compensation structure. *See* FINRA Conflicts Report. An effective practice FINRA observed at a number of firms is implementation of a comprehensive framework to identify and manage conflicts of interest across and within firms' business lines that is scaled to the size and complexity of their business. *See* FINRA Conflicts Report at 5.

[316] *See* FINRA Conflicts Report at 26.

[317] As noted above, while the Commission believes these practices, if incorporated into written policies and procedures, may reasonably mitigate conflicts of interest arising from financial incentives, whether a recommended securities transaction or investment strategy complies with proposed Regulation Best Interest will turn on the facts and circumstances of the particular recommendation and the particular retail customer, and whether the broker-dealer has complied with the Disclosure Obligation and the Care Obligation.

[318] *Id.*

[319] *See* FINRA Exam Report 2017. FINRA observed a variety of effective practices in recommending the purchase and sale of certain products, including tailoring supervisory systems to products' features and sources of risk to customers. With respect to UITs, FINRA observed firms that alerted customers to the consequences of selling and reinvesting in a new UIT prior to the initial UIT's maturity using negative or positive consent letters. Some firms implemented surveillance patterns to identify early UIT rollovers under a variety of scenarios. In addition, some firms required registered representatives to enter a rationale into firm systems for each short-term UIT transaction and coupled the entry with documented supervisory review.

[320] *See* Tully Report. The Tully Report found the payment of up-front bonuses and accelerated payouts raised concerns not about particular recommendations but about the registered representative-client relationship because registered representatives are incentivized to generate large commissions through churning accounts or switching firms. The Tully Report suggested best practices to encourage long-term relationships through methods including, but not limited to, possible elimination of up-front bonuses or payment of up-front bonuses in the form of forgivable loans over a period of time.

assets under management.[321] Broker-dealers that make recommendations to retail customers that may involve such compensation practices should carefully assess the broker-dealer's ability to mitigate these financial incentives and whether they can satisfy their best interest obligation.

f. Consistency With Other Approaches

The Commission believes that the proposed requirements relating to the treatment of conflicts are designed to address, albeit in a less prescriptive manner, the same concerns regarding broker-dealer conflicts of interest as expressed by the DOL in adopting the DOL Fiduciary Rule and related PTEs, including the conflicts associated with financial incentives, underlying the BIC Exemption. Among other things, the BIC Exemption includes provisions requiring: (1) Disclosure of information on the firm's material conflicts of interest, including web and transaction-based disclosure; and (2) adoption of policies and procedures reasonably designed to: (i) Ensure that advisers (*i.e.,* individual representatives) adhere to the Impartial Conduct Standards (*e.g.,* provide best interest advice); (ii) prevent material conflicts of interest from causing violations of the Impartial Conduct Standards, and (iii) prevent the use of compensation or other incentives (*e.g.,* quotas, appraisals, bonuses, contests, special awards, differential compensation or other actions or incentives) that are intended or would reasonably be expected to cause advisers to make recommendations that are not in the best interest of the retirement investor.[322]

The DOL has stated that the restriction on compensation incentives under the conditions of the BIC Exemption does not prevent the provision of differential compensation to individuals (whether in type or amount, and including, but not limited to, commissions) based on investment decisions to the extent that the policies and procedures and incentive practices, when viewed as a whole, are reasonably and prudently designed to avoid a misalignment of the interests of advisers with the investors they serve as fiduciaries.[323] However, the differential payments must be based on neutral factors, such as the time or complexity and the work involved (and not based on what is more lucrative to the firm), and the DOL noted the importance of employing supervisory oversight structures.[324] As an example, the DOL described a commission-based compensation schedule for representatives in which all variation in commissions is eliminated for recommendations of investments within reasonably designed categories, and the entity establishes supervisory mechanisms to protect against conflicts of interest created by the transaction-based model and takes special care to ensure that any differentials that are retained are based on neutral factors (*e.g.,* time or complexity) and do not incentivize based on the amount of compensation the entity would receive.[325]

Our proposed Conflict of Interest Obligations are designed to address these same concerns, and support the objective that the recommendations of broker-dealers will not be self-interested, with a principles-based approach that is designed to provide flexibility to broker-dealers as to how to disclose and mitigate such conflicts of interest, depending on their business model, the level of conflicts presented, and the retail customers they serve. While the Commission recognizes that broker-dealers are subject to supervisory obligations under Section 15(b)(4)(E)[326] of the Exchange Act and detailed SRO rules, including the establishment of policies and procedures reasonably designed to prevent and detect violations of, and to achieve compliance with, the federal securities laws and regulations, as well as applicable SRO rules,[327] for the reasons set forth above, the Commission believes that broker-dealers should be expressly required to establish, maintain, and enforce written policies and procedures to identify and address (through elimination or disclosure, and mitigation in the case of financial incentives) material conflicts of interest .

Furthermore, our proposed rule subjects broker-dealers to additional requirements when certain material conflicts are present. Specifically, Regulation Best Interest requires written policies and procedures reasonably designed to identify and address, through disclosure or elimination, of any material conflicts of interest that are associated with the recommendation, and imposes heightened obligations requiring written policies and procedures reasonably designed to identify and address, through disclosure and mitigation, or elimination, of material conflicts of interest that are related to financial incentives. We believe that these requirements address the same concerns that the DOL sought to address regarding conflicts of interest and the duty of loyalty that underlies the detailed obligations of the BIC Exemption, and also help ensure investment recommendations will be in the retail customer's best interest, consistent with our understanding of the DOL's objectives in the BIC exemption.

We also believe that the proposed Conflict of Interest Obligations, in conjunction with our Disclosure Obligation, are consistent with the principles underlying the recommendations of the 913 Study relating to a duty of loyalty. In the uniform fiduciary standard recommended in the Study, ''incorporating Advisers Act Section 206(1) and 206(2)'' would require an investment adviser or broker-dealer to ''eliminate, or provide full and fair

[321] For example, FINRA rules establish restrictions on the use of non-cash compensation in connection with the sale and distribution of mutual funds, variable annuities, direct participation program securities, public offerings of debt and equity securities, and real estate investment trust programs. These rules generally limit the manner in which members can pay for or accept non-cash compensation and detail the types of non-cash compensation that are permissible. *See* FINRA Rules 2310, 2320, 2331, and 5110. FINRA conducted a retrospective review of the gifts and gratuities and non-cash compensation rules to assess their effectiveness and efficiency. *See* FINRA Regulatory Notice 14–15, FINRA Requests Comment on the Effectiveness and Efficiency of its Gifts and Gratuities and Non-Cash Compensation Rules (Apr. 2014); FINRA Retrospective Rule Report, Gifts, Gratuities and Non-Cash Compensation (Dec. 2014). In response, SIFMA commented that it supported ''restricting the use of sales targets and requiring that eligibility for training events be determined on the basis of total production, not the sale of specific securities'' and recommended that ''FINRA also consider whether these rules should be applied consistently to all securities products, rather than (as today) just to investment company securities, variable products and public offerings of securities.''). *See* Letter from Kevin A. Zambrowicz, Associate General Counsel & Managing Director, SIFMA (May 23, 2014).

[322] *See* BIC Exemption Release.

[323] *See* BIC Exemption Release at 21033–34. *See also* U.S. Department of Labor, Employee Benefits Security Administration, Conflict of Interest FAQs, Part I-Exemptions (Oct. 2017), *available at https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf* (''DOL FAQs Part I'').

[324] *See* BIC Exemption Release at 21035–40. For example, the DOL notes that the touchstone is to always avoid structures that misalign the financial interests of the adviser with the interests of the retirement investor. *See* DOL FAQs Part I.

[325] *See* BIC Exemption Release 21038–39. *See also* DOL FAQs at 7–8.

[326] *See* Section 15(b)(4)(E) of the Exchange Act (authorizing the Commission to impose sanctions on a firm or any associated person that fails reasonably to supervise another person subject to their supervision that commits a violation of the federal securities laws).

[327] *See* FINRA Rule 3110 (Supervision) (requiring firms to establish and maintain systems to supervise the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules).

disclosure about its material conflicts of interest.'' [328] In addition, the Study recommended that the Commission consider whether rulemaking ''would be appropriate to prohibit certain conflicts, to require firms to mitigate conflicts through specific action, or to impose specific disclosure and consent requirements.'' [329] Further, with respect to principal trading, the Study provided that the Commission should address how broker-dealers should fulfill the uniform fiduciary standard when engaging in principal trading.[330] The Study noted that under the standard a broker-dealer should be required at a minimum, to disclose its conflicts of interest related to principal transactions, including its capacity as principal, but it would not necessarily be required to follow the specific notice and consent procedures of Advisers Act Section 206(3).[331]

We believe that the proposed Conflict of Interest Obligations reflect and build upon the principles underlying these 913 Study recommendations. As recommended by the 913 Study, we are proposing to require, through implementation of policies and procedures, broker-dealers to, at a minimum disclose, or eliminate, all material conflicts of interest, which draws from principles of an investment adviser's duty of loyalty under the Advisers Act, which includes an investment adviser's duty to disclose. One difference between the Conflict of Interest Obligations under Regulation Best Interest and the principles in the 913 Study is that the proposed obligation for broker-dealers is limited to disclosure of material conflicts associated with a recommendation. As discussed above, the Commission believes this limitation is appropriate because broker-dealers often provide a range of services as part of any retail customer relationship, many of which would not involve a recommendation, and such services already are subject to general and specific requirements to address associated conflicts of interest.[332] As such, we are not proposing to change or to have any impact on the disclosure obligations associated with these services under the general antifraud provisions of the federal securities laws rather than this more specific obligation.

Further, in line with the 913 Study recommendations as discussed above, the Commission considered and believes that it is appropriate to also propose a requirement to establish and maintain reasonably designed policies and procedures to disclose and mitigate, or eliminate, material conflicts of interest related to financial incentives, in light of the concerns regarding potential harm to retail customers resulting particularly from broker-dealer conflicts of interest associated with financial incentives, such as compensation practices.[333]

The proposed Conflict of Interest Obligations differ from the 913 Study in that Regulation Best Interest, as proposed, expressly requires a broker-dealer to establish, maintain, and enforce written policies and procedures reasonably designed to identify and address material conflicts, through elimination or disclosure (and mitigation in the case of material conflicts of interest arising from financial incentives), as opposed to expressly requiring that broker-dealers eliminate or provide full disclosure of conflicts of interest.[334] As discussed above, the Disclosure Obligation separately requires that broker-dealers disclose material conflicts of interest associated with the recommendation prior to or at the time of a recommendation. For the reasons set forth above, we believe that requiring broker-dealers to develop reasonably designed policies and procedures to identify and eliminate or disclose (and mitigate, as appropriate or required) material conflicts of interest is critical to compliance with management of conflicts of interest, and provides more flexibility to broker-dealers, and better serves the Commission's goal of facilitating the elimination or disclosure and mitigation (as appropriate or required) of material conflicts of interest, and minimizing additional compliance costs that may be passed on to retail customers.

g. Request for Comment on the Conflict of Interest Obligations

The Commission generally requests comment on the best interest obligation relating to the treatment of conflicts of interest. Specifically, we request comment on the following issues:

- Would the Conflict of Interest Obligations cause a broker-dealer to act in a manner that is consistent with what a retail customer would reasonably expect from someone who is required to act in their best interest? Why or why not?
- Should the Conflict of Interest Obligations apply to natural persons who are associated persons of a broker or dealer? Why or why not?
- Are there any specific interactions or relationships between the disclosure requirements under the Conflict of Interest Obligations and the Relationship Summary that should be addressed? Are there any specific interactions or relationships between the disclosure requirements under the Conflict of Interest Obligations and the Disclosure Obligation that should be addressed? If so, please explain.
- Are there any specific interactions or relationships between the disclosure requirements in Regulation Best Interest and the existing general antifraud provisions that should be addressed? If so, please explain.
- Do commenters believe the general antifraud provisions adequately address other non-recommendation related conflicts or should Regulation Best Interest also cover such conflicts?
- Do commenters agree with the requirement to create policies and procedures to promote and demonstrate compliance with the Conflict of Interest Obligations? Why or why not? If so, how should those policies and procedures differ, if at all, from those currently required by FINRA? If not, what other approaches do commenters suggest?
- Instead of requiring policies and procedures, should the Commission simply require broker-dealers to eliminate or mitigate and disclose conflicts of interest?
- Should the Conflict of Interest Obligations apply to natural persons who are associated persons? Why or why not?
- Do commenters agree with the Commission's approach to provide flexibility to broker-dealers in meeting their Conflict of Interest Obligations? Why or why not?
- Is the guidance concerning policies and procedures clear? Would this guidance assist broker-dealers in understanding how they can demonstrate compliance with the Conflict of Interest Obligation? Is there additional guidance that would provide additional clarity?
- Do commenters have additional examples of processes or systems the Commission should suggest or require broker-dealers to include in compliance and supervisory programs?
- Should the Conflict of Interest Obligations specify certain minimum policies and procedures? If so, what specific required policies and procedures should we include?
- Should the Commission require in Regulation Best Interest that broker-dealers undergo supervisory and compliance reviews? If so, how

[328] 913 Study at 112–13.

[329] *See id.* at 118.

[330] *See id.* at 118–20.

[331] *Id.*

[332] *See* Section II.D.1.b.

[333] *See supra* Section I.A. *See also* Tully Report.

[334] See 913 Study at 112–13.

frequently and what would be the proper scope?

• Is it sufficiently clear to commenters that the Commission does not require the policies and procedures required by the Conflict of Interest Obligations be assessed on a transaction-by-transaction basis, but rather that broker-dealers may use a risk-based compliance and supervisory system? Why or why not?

• Should the Commission provide additional guidance on identification of material conflicts of interest? Why or why not? If so, what type of guidance should the Commission provide?

• Similar to the Care Obligation, should a broker-dealer be required to ''exercise reasonable diligence, care, skill, and prudence'' to comply with the Conflict of Interest Obligations? Why or why not? Would this lower or raise the standard for the Conflict of Interest Obligations?

• How will the Conflict of Interest Obligations affect dual-registrants? Do commenters believe dual-registrants can adequately comply with such requirements? Why or why not?

• Are the situations identified in this proposal those where conflicts of interest are present, the most prevalent or have the greatest potential for harm or both? To what extent are retail customers harmed by these types of conflicts? [335] For example, do certain types of conflicts and/or recommendations result in systematically lower net returns or greater degrees of risk in retail customers' portfolios relative to other similarly situated investors in different relationships (*e.g.,* investment adviser, bank and trust company, insurance company accounts)? Are there steps the Commission should take to identify and address these conflicts? Can they be appropriately addressed through disclosure or other means? How would any such steps to address potential conflicts of interest benefit retail customers currently and over time? What costs or other consequences, if any, would retail customers experience as a result of any such steps? For example, would broker-dealers be expected to withdraw from or limit their offerings or services in certain markets or certain products?

• Has the Commission identified the types of conflicts of interest that need to be addressed in connection with Regulation Best Interest and are these appropriately addressed to meet the objective that broker-dealers provide recommendations in the best interest of retail customers? Are there new or different types of conflicts of interest that the Commission should consider? If so, which ones?

• Do commenters have other suggestions on how broker-dealers can eliminate material conflicts of interest, including financial incentives? If so, please provide examples.

• Do commenters agree with the scope of the Commission's proposed requirement related to disclosure and mitigation, or elimination, of all material conflicts of interest arising from financial incentives? Do commenters agree with the proposed interpretation of such financial incentives? Why or why not? Please explain. Do commenters believe any financial incentives could be adequately addressed through disclosure or elimination (and do not require mitigation)? If so, which ones? Why or why not? Which material conflicts of interest do commenters believe must be mitigated? Why?

• Do commenters believe that retail customers recognize and understand material conflicts of interest presented by broker-dealer compensation arrangements, including the incentive to seek to increase broker-dealers' compensation at the expense of the retail customers they are advising?

• In lieu of or in addition to disclosure, should the Commission explicitly require firms to mitigate conflicts generally and not only those arising from financial incentives? Why or why not? Or should we provide flexibility to firms to decide whether to disclose or mitigate conflicts generally (*e.g.,* to provide flexibility to firms on how to address conflicts of interest)? Or are there certain conflicts beyond financial incentives, that should be both disclosed and mitigated (or eliminated)?

• Are there circumstances in which the Commission should explicitly require elimination of certain material conflicts of interest because mitigation would not be sufficient? Why or why not? If so, please specify which ones.

• Should Regulation Best Interest expressly require broker-dealers to regularly (*e.g.,* at least annually) and rigorously review their written policies and procedures to make sure that they have supervisory and compliance systems to identify and address all of their material conflicts of interest?

• Commenters in the past have highlighted several activities of broker-dealers that are most likely to be impacted by an enhanced standard of care for the provision of investment advice to retail customers, such as a fiduciary standard. The Commission requests data and other information related to the nature and magnitude of conflicts of interest when broker-dealers engage in these activities and how Regulation Best Interest would serve to increase or decrease broker-dealers' conflicts of interest:

○ Recommending proprietary products and products of affiliates;

○ Engaging in principal trades with respect to a recommended security (*e.g.,* fixed income products);

○ Recommending a limited range of products and/or services;

○ Recommending a security underwritten by the firm or a broker-dealer affiliate, including initial public offerings;

○ Allocating investment opportunities among retail customers (*e.g.,* IPO allocation);

○ Receiving third-party compensation in connection with securities transactions or distributions (*e.g.,* sales loads, ongoing asset-based fees, or revenue sharing); and

○ Providing ongoing, episodic or one-time advice.

The Commission also requests comment on reasonable conflict mitigation measures, specifically:

• What factors should broker-dealers weigh and evaluate in establishing reasonable mitigation measures?

• Should the Commission take a more prescriptive approach with regard to conflict mitigation measures? Why or why not?

• Do commenters have further examples of potential mitigation measures beyond the non-exhaustive list provided above? Do commenters believe that any of the examples provided on the list would not be effective at mitigating conflicts related to financial incentives? Why or why not?

• What impact should the firm's size have on implementation of reasonable mitigation measures?

• Are there conflicts of interest that commenters believe the Commission should prohibit? If so, which ones and why? For example, do commenters believe the Commission should prohibit receipt of certain non-cash compensation (*e.g.,* sales contests, trips, prizes, and other bonuses based on sales of certain securities, accumulation of assets under management or any other factor)? Why or why not?

• Should the Commission require affirmative retail customer consent for certain types of conflicts of interest? Why or why not?

[335] *See* Definition of the Term ''Fiduciary;'' Conflict of Interest Rule—Retirement Investment Advice, 81 FR 20945 (Apr. 8, 2016) (to be codified at 29 CFR pts. 2509, 2510 and 2550) (stating that conflicts of interest with respect to transactions pose ''special dangers to the security of retirement, health, and other benefit plans'').

• Would the guidance related to mitigating conflicts provide clarity to firms? Why or why not? Is this guidance consistent with the Commission's goal of improving the quality of recommendations that retail customers receive? What are some areas in which commenters would like more guidance?

• Are there certain product classes that commenters believe the Commission should outright prohibit? If so, which ones and why?

• Do commenters believe neutral compensation across certain products (*e.g.,* equities, mutual funds, variable annuities, ETFs) is an appropriate mitigation measure? Why or why not?

E. Recordkeeping and Retention

In connection with proposed Regulation Best Interest, we are proposing new record-making and recordkeeping requirements for broker-dealers with respect to certain information collected from or provided to retail customers. Exchange Act Section 17(a)(1) requires registered broker-dealers to make and keep for prescribed periods such records as the Commission deems ''necessary or appropriate in the public interest, for the protection of investors.'' [336] Exchange Act Rules 17a–3 and 17a–4 specify minimum requirements with respect to the records that broker-dealers must make, and how long those records and other documents must be kept, respectively.

Under Rule 17a–3(a)(17), broker-dealers that make recommendations for accounts with a natural person as customer or owner are required to create and periodically update customer account information.[337] As part of developing a ''retail customer's investment profile,'' proposed Regulation Best Interest may require broker-dealers to seek to obtain certain retail customer information that is currently not required pursuant to Rule 17a–3(a)(17). In addition, proposed Regulation Best Interest would require broker-dealers to reasonably disclose in writing the material facts relating to the scope and terms of their relationship with the retail customer and all material conflicts of interest that are associated with the investment recommendations provided to the retail customer.

Accordingly, we are proposing to amend Rule 17a–3 to add a new paragraph (a)(25), which would require, for each retail customer to whom a recommendation of any securities transaction or investment strategy involving securities is or will be provided, a record of all information collected from and provided to the retail customer pursuant to Regulation Best Interest, as well as the identity of each natural person who is an associated person of a broker or dealer, if any, responsible for the account. The new paragraph would specify, however, that the neglect, refusal, or inability of a retail customer to provide or update any such information would excuse the broker-dealer from obtaining that information.[338]

Under Rule 17a–4(e)(5), broker-dealers are required to maintain and preserve in an easily accessible place all account information required pursuant to Rule 17a–3(a)(17) [339] for six years.[340] We are proposing to amend Exchange Act Rule 17a–4(e)(5) to require broker-dealers to retain any information that the retail customer provides to the broker-dealer or the broker-dealer provides to the retail customer pursuant to Rule 17a–3(a)(25), in addition to the existing requirement to retain information obtained pursuant to Rule 17a–3(a)(17). As a result, broker-dealers would be required to retain all of the information collected from or provided to each retail customer pursuant to Regulation Best Interest for six years.

We are not proposing new record retention requirements regarding the written policies and procedures that broker-dealers would be required to create pursuant to Regulation Best Interest because such information is already currently required to be retained pursuant to Exchange Act Rule17a–4(e)(7).[341] Rule 17a–4(e)(7) requires broker-dealers to retain compliance, supervisory, and procedures manuals (and any updates, modifications, and revisions thereto) describing the policies and practices of the broker-dealer with respect to compliance with applicable laws and rules, and supervision of the activities of each natural person associated with the broker-dealer, for a specified period of time.

The Commission requests comment on recordkeeping and retention requirements related to Regulation Best Interest:

• Should the Commission impose additional record-making requirements related to Regulation Best Interest? Why or why not? If the Commission were to adopt additional requirements, what records should we specifically require broker-dealers to make?

• Should the Commission impose additional record retention requirements related to Regulation Best Interest? Why or why not? If the Commission were to adopt additional requirements, what records should we specifically require broker-dealers to retain?

F. Whether the Exercise of Investment Discretion Should Be Viewed as Solely Incidental to the Business of a Broker or Dealer

The Advisers Act regulates the activities of certain ''investment advisers,'' who are defined in section 202(a)(11) of the Advisers Act as persons who, for compensation, engage in the business of advising others about securities. Section 202(a)(11)(C) excludes from the definition of investment adviser a broker or dealer whose performance of such advisory services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation for those services (the ''broker-dealer exclusion''). The broker-dealer exclusion shows, on the one hand, that Congress recognized broker-dealers may give a certain amount of advice to their customers in the course of their regular business as broker-dealers and that it would be inappropriate to bring them within the scope of the Advisers Act merely because of this aspect of their

[336] *See* Exchange Act Section 17(a).

[337] *See* Exchange Act Rule 17a–3(a)(17).

[338] Rule 17a–3(a)(17) applies to each account with a natural person as a customer or owner, while proposed Regulation Best Interest would apply to each recommendation of any securities transaction or investment strategy involving securities to a retail customer. Because of this difference, the Commission believes it would be appropriate to locate the record-making requirements related to Regulation Best Interest in a new paragraph of Rule 17a–3 rather than in an amendment to paragraph (a)(17).

[339] Under Rule 17a–3(a)(17), broker-dealers that make recommendations for accounts with a natural person as customer or owner are required to create, and periodically update, customer account information. As part of developing a ''retail customer's investment profile,'' proposed Regulation Best Interest would require broker-dealers to seek to obtain certain retail customer information that is currently not required to be created under Rule 17a–3(a)(17). Because broker-dealers are already required to seek to obtain identical information pursuant to the FINRA suitability rule, we believe that broker-dealers should already be attempting to collect, pursuant to the FINRA suitability rule, or collecting under existing Exchange Act books and records rules, the information that would be required pursuant to Regulation Best Interest. Accordingly, we do not believe that it is necessary to impose any new record-making requirement upon broker-dealers.

[340] *See* Exchange Act Rule 17a–4(e)(5) (account record information required pursuant to Rule 17a–3(a)(17) must be maintained and preserved in an easily accessible place until at least six years after the earlier of the date the account was closed, or the date on which the information was replaced or updated).

[341] FINRA Rule 3110 requires written supervisory procedures that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules. *See* FINRA Rule 3110(b)(1) (Supervision).

business.[342] On the other hand, the limitations of the exclusion show that Congress also recognized certain broker-dealer advisory services belong within the scope of the Advisers Act—namely those for which they receive special compensation and those that are not solely incidental to their regular business as broker-dealers.[343]

The Commission has on many occasions discussed the scope of the broker-dealer exclusion. In particular, the Commission has for many years considered issues related to a broker-dealer's exercise of investment discretion over customer accounts and the extent to which such practices could be considered solely incidental to the business of a broker-dealer. Since at least 1978, the Commission has recognized that the broker-dealer exclusion requires some limitations on a broker-dealer's exercise of investment discretion. At that time, the Commission solicited comment on the question of whether broker-dealers who exercised discretionary authority over customers' accounts should, *per se,* be considered investment advisers with respect to those accounts.[344] While the Commission declined to adopt such an interpretation at that time, it noted that if the business of a broker-dealer consisted almost exclusively of managing accounts on a discretionary basis, the Commission staff would not consider the broker-dealer to be providing investment advice that is solely incidental to its business as a broker-dealer.[345] In 2005, the Commission adopted an interpretive rule [346] that, among other things, provided that broker-dealers are not excluded from the Advisers Act for any accounts over which they exercise more than temporary or limited investment discretion.[347] The 2005 interpretation regarding investment discretion was part of a rule whose principal purpose was to permit broker-dealers to offer fee-based brokerage accounts (where a customer pays an asset-based fee) without being subject to the Advisers Act with respect to those accounts.[348] In 2007, the rule was vacated by the U.S. Court of Appeals for the District of Columbia Circuit on the grounds that the Commission did not have the authority to except broker-dealers offering fee-based brokerage accounts from the definition of ''investment adviser.'' [349] Though the Court did not specifically address the validity of the provision regarding investment discretion, it vacated the entire rule. After the rule was vacated, the Commission proposed in 2007, though did not adopt, a similar interpretive rule regarding investment discretion.[350]

In considering why limitations on broker-dealers' exercise of investment discretion are needed, the Commission has noted that discretionary brokerage relationships ''have many of the characteristics of the relationships to which the protection of the Advisers Act are important.'' [351] In particular, the Commission has noted that the exercise of investment discretion is qualitatively distinct from simply providing advice as part of a package of brokerage services, because a broker-dealer with such discretion is not just a source of *advice,* but has authority to make investment *decisions* relating to the purchase or sale of securities on behalf of customers.[352] The Commission has stated that the quintessentially supervisory or managerial character of investment discretion warrants the protection of the Advisers Act and its attendant fiduciary duty.[353] This position aligns with the interpretations of the courts, which have generally found that broker-dealers with investment discretion owe customers a fiduciary duty under state law.[354]

At the same time, the Commission has recognized that at least some exercise of discretionary authority by broker-dealers could be considered solely incidental to their business. Under a previous interpretation, a broker-dealer's discretionary account was subject to the Advisers Act only if the broker-dealer had enough other discretionary accounts to trigger the Advisers Act.[355] The interpretive

[342] *Opinion of General Counsel Relating to Section 202(a)(11)(C) of the Investment Advisers Act of 1940,* Investment Advisers Act Release No. 2 (Oct. 28, 1940) (''Advisers Act Release No. 2'').

[343] In 1940, when Congress enacted the Advisers Act, broker-dealers were already regulated under the Exchange Act. In the Advisers Act, Congress expressly acknowledged that the broker-dealers it covered could also be subject to other regulation. 15 U.S.C. 80b–8(b). Judicial interpretation of the broker-dealer exclusion also has noted that Congress passed the Advisers Act to provide certain protections to the public when receiving investment advice and that there is nothing in the legislative history of the Advisers Act ''to suggest that Congress was particularly concerned about the regulatory burdens on broker-dealers'' associated with their being subject to the Advisers Act in addition to Exchange Act. *Financial Planning Association* v. *SEC,* 482 F.3d 481(D.C. Cir. 2007) (''*Financial Planning Association* v. *SEC*'') (noting additionally that ''[j]ust as the text and structure of paragraph 202(a)(11) make it evident that Congress intended to define 'investment adviser' broadly and create only a precise exemption for broker-dealers, so does a consideration of the problems Congress sought to address in enacting the IAA'' and stating that the Advisers Act sought to address these problems ''by establishing a federal fiduciary standard to govern the conduct of investment advisers, broadly defined'' and ''by requiring full disclosure of all conflicts of interest'').

[344] *Final Extension of Temporary Rules,* Advisers Act Release No. 626 (Apr. 27, 1978) (''Advisers Act Release No. 626'').

[345] *Applicability of the Investment Advisers Act to Certain Brokers and Dealers,* Investment Advisers Act Release No. 640 (Oct. 5, 1978) [43 FR 47176 (Oct. 13, 1978)] (''Advisers Act Release No. 640'').

[346] Original rule 202(a)(11)–1 under the Advisers Act.

[347] *See Certain Broker-Dealers Deemed Not to be Investment Advisers,* Advisers Act Release No. 2340 (Jan. 6, 2005) (''2005 Proposing Release''*); Certain Broker-Dealers Deemed Not to be Investment Advisers,* Advisers Act Release No. 2376 (Apr. 12, 2005) (''2005 Adopting Release'').

[348] *See* 2005 Adopting Release, *supra* note 347. Fee-based brokerage accounts are similar to traditional full-service brokerage accounts, which provide a package of services, including execution, incidental investment advice, and custody. The primary difference between the two types of accounts is that a customer in a fee-based brokerage account pays a fee based upon the amount of assets on account (an asset-based fee) and a customer in a traditional full-service brokerage account pays a commission (or a mark-up or mark-down) for each transaction.

[349] *See Financial Planning Association* v. *SEC, supra* note 343.

[350] *Interpretive Rule Under the Advisers Act Affecting Broker-Dealers,* Investment Advisers Act Release No. 2652 (Sept. 24, 2007) (''2007 Proposing Release'').

[351] Advisers Act Release No. 626.

[352] *See* 2005 Proposing Release; *see also* 2007 Proposing Release.

[353] *See Amendment and Extension of Temporary Exemption From the Investment Advisers Act for Certain Brokers and Dealers,* Investment Advisers Act Release No. 471 (Aug. 20, 1975)(''. . . it is not appropriate to exempt from the Advisers Act for an extended period those brokers and dealers who perform investment supervisory services or other investment management services because of the special trust and confidence inherent in the relationships between such brokers and dealers and their advisory clients.''). *See also* 2005 Proposing Release; 2005 Adopting Release; and 2007 Proposing Release.

[354] *See, e.g., United State* v. *Skelly,* 442 F.3d 94 at 98 (2d Cir. 2006) (fiduciary duty found ''most commonly'' where ''a broker has discretionary authority over the customer's account''); *United States* v. *Szur,* 289 F.3d 200 at 211 (2d Cir. 2002) (''Although it is true that there 'is no general fiduciary duty inherent in an ordinary broker/customer relationship,' a relationship of trust and confidence does exist between a broker and a customer with respect to those matters that have been entrusted to the broker.'') (citations omitted); *Leib* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 461 F. Supp. 951, 953–54 (E.D. Mich. 1978), *aff'd,* 647 F.2d 165 (6th Cir. 1981) (stating that courts have held that a broker who has *de facto* control over a non-discretionary account generally owes customer duties of a fiduciary nature; looking to customer's sophistication, and the degree of trust and confidence in the relationship, among other things, to determine duties owed). *See also* Arthur B. Laby, *Fiduciary Duty of Broker-Dealers and Investment Advisers,* 55 VILL. L. REV. 3 (2010) (''most courts and commentators agree that when a broker has discretionary authority, the broker owes fiduciary duties to its customer''); Barbara Black, *Brokers and Advisers—What's in a Name?,* 11 FORDHAM J. CORP. & FIN. L. 31, 36 (2005) (stating that broker-dealers generally do not owe a fiduciary duty unless operating with discretion).

[355] A broker-dealer who exercised discretionary authority over the accounts of some of its customers was generally regarded as providing investment advice incidental to its business as a broker-dealer but a broker-dealer whose business consisted almost exclusively of managing accounts on a discretionary basis was not regarded as providing

provision that we adopted in 2005 and proposed in 2007 would have required broker-dealers to be considered to be investment advisers under the Advisers Act with respect to discretionary accounts, except that broker-dealers would have been permitted to exercise investment discretion on a temporary or limited basis.[356]

Although we did not adopt our 2007 proposal, many commenters were generally supportive of our approach.[357] We believe that much of the financial industry has treated broker-dealers as not excluded from the Advisers Act for any accounts over which they exercise more than temporary or limited investment discretion. Most commenters to the Chairman's recent request for comment, including broker-dealers, have indicated that financial firms generally treat discretionary accounts as advisory accounts.[358]

Our staff acknowledged that broker-dealers may provide some discretionary account services in the 913 Study.[359] We have also long recognized that a broker-dealer's ability to engage in discretionary activity is circumscribed by existing rules under the federal securities laws.[360] In addition, broker-dealers that engage in any discretionary activity are subject to SRO Rules that prohibit and require specific conduct with respect to discretionary accounts.[361] Further, broker-dealers vested with discretionary authority or that exercise control over customer assets have been held to a fiduciary standard under state law.[362]

We believe that it is appropriate for the Commission to again consider the scope of the broker-dealer exclusion with regard to a broker-dealer's exercise of investment discretion in light of both proposed Regulation Best Interest and the proposed Relationship Summary. Additionally, some commenters to the Chairman's request asked that we expressly affirm the interpretive provision we adopted in 2005 and proposed in 2007.[363]

In light of the foregoing, we request comment on the following:

• Should a broker-dealer's provision of unfettered discretionary investment advice be considered solely incidental to the conduct of its business as a broker-dealer?

• Should a broker-dealer's provision of limited discretionary investment advice be considered solely incidental to the conduct of its business as a broker-dealer? If so, what limitations on a broker-dealer's exercise of investment discretion would make it solely incidental to the conduct of its business as a broker-dealer?

• Should we propose an interpretive rule placing express limits on investment discretion permissible under the solely incidental exclusion as we did in 2007? What would be the consequences of such a rule?

• In 2007, we proposed to permit broker-dealers to exercise investment discretion granted by a customer on a temporary or limited basis. Is that appropriate? Would it provide the intended investor protection? Would it provide the clarity regarding the applicable business model and standard of care?

• In 2007 we provided examples of when we would consider a broker-dealer's investment discretion to be temporary or limited.[364] Should we define situations in which investment discretion should be viewed as being granted on a temporary or limited basis? For example, should temporary investment discretion last no more than a very limited time (*i.e.,* not as long as two or more months)? Should we restrict a broker-dealer's ability to exercise temporary investment discretion repeatedly? Should limited discretion ''to purchase or sell a security or type of security limited by specific parameters established by the customer'' be restricted?[365] What are some examples of specific parameters that a customer could establish under this example? Should we expand any of the situations in which investment discretion could be viewed as being granted on a temporary or limited basis? For example, should we explicitly allow brokers to exercise investment discretion granted by the customer to rebalance the customer's account or to invest a limited portion of the account in a particular sector?

• Do broker-dealers generally use the examples from the 2007 release to determine when to seek authorization to exercise temporary or limited investment discretion from a customer? Are there other circumstances that cause broker-dealers to seek authorization to exercise investment discretion?

• The Commission requests data and other information related to the nature and magnitude of discretionary services offered by broker-dealers. To what extent do broker-dealers offer a range of discretionary brokerage accounts? What is the range of discretionary services offered, and what types of limits do broker-dealers apply to such services?

• We understand that dually-registered firms generally treat discretionary accounts as advisory accounts. Is this understanding correct? To what extent and under what circumstances do broker-dealers treat discretionary accounts as brokerage accounts? If broker-dealers offer

advice solely incidental to his business as a broker-dealer. *See* Advisers Act Release No. 626.

[356] The Commission stated that it would view a broker-dealer's discretion to be temporary or limited within the meaning of proposed rule 202(a)(11)–1(d) when the broker-dealer was given discretion: (i) As to the price at which or the time to execute an order given by a customer for the purchase or sale of a definite amount or quantity of a specified security; (ii) on an isolated or infrequent basis, to purchase or sell a security or type of security when a customer is unavailable for a limited period of time not to exceed a few months; (iii) as to cash management, such as to exchange a position in a money market fund for another money market fund or cash equivalent; (iv) to purchase or sell securities to satisfy margin requirements; (v) to sell specific bonds and purchase similar bonds in order to permit a customer to take a tax loss on the original position; (vi) to purchase a bond with a specified credit rating and maturity; and (vii) to purchase or sell a security or type of security limited by specific parameters established by the customer. *See* 2005 Proposing Release; 2005 Adopting Release; 2007 Proposing Release. In the 2005 Adopting Release, we noted that accounts in which broker-dealers exercised such investment discretion would continue to be subject to the existing Exchange Act and SRO rules concerning broker-dealer exercise of investment discretion. *See* 2005 Adopting Release.

[357] *See, e.g.,* Letter of the Consumer Federation of America and Fund Democracy (Nov. 2, 2007); Letter of the Investment Adviser Association (Nov. 2, 2007); Letter of Charles McKeown (Oct. 30, 2007); and Letter of the Securities Industry and Financial Markets Association (Nov. 2, 2007).

[358] *See* T. Rowe Letter; Stifel Letter (''In simple terms, Brokerage relationships are non-discretionary, commission-based accounts, through which a financial professional provides episodic investment advice incidental to each transaction. By contrast, in an Advisory relationship, a financial professional generally provides ongoing investment advice and monitoring and charges a level fee, generally based on assets.); *see* ICI August 2017 Letter (''broker-dealers typically do not exercise discretionary authority over customer accounts''); Vanguard Letter (''The investment advisory business model is significantly different from that of a broker-dealer. Advisers generally provide ongoing advice for a fee, take discretion over client accounts, and engage other entities to carry client accounts and handle client trading.'').

[359] *See* 913 Study at 9–10.

[360] *See, e.g.,* Exchange Act Section 3(a)(35) (defining investment discretion). 17 CFR 240.15c1–7.

[361] *See* NASD Rule 2510 (Discretionary Accounts) and Incorporated NYSE Rule 408 (Discretionary Power in Customers' Accounts). Drawing upon the requirements of these rules and SRO suitability rules, the Commission has found the exercise of discretion over a customer's account may constitute a ''recommendation'' that additionally subjects a broker-dealer's discretionary activity to SRO suitability requirements. *See, e.g., In re Application of Paul C. Kettler,* Exchange Act Release No. 31354, 1992 WL 320802, *3, n.11 (1992). *See also In re James Harman McNeill,* (Case No. 2012030927101, AWC, Mar. 12, 2013), *available at http://www.finra.org/sites/default/files/fda_documents/2012030927101_FDA_TP44051.pdf* (associated person violated FINRA Rule 2510(b) by exercising discretion in five customers' brokerage accounts without the written authorization of the customers). *See also supra* note 139 and accompanying text.

[362] *See supra* note 15.

[363] IAA Letter; CFA 2017 Letter.

[364] *See supra* note 356.

[365] *Id.*

discretionary management in brokerage accounts, who are the typical investors in those accounts?

• Section 3(a)(35) of the Exchange Act defines ''investment discretion.'' [366] Should we consider a different, narrower definition of discretionary management that would be deemed solely incidental to the brokerage business?

• Do broker-dealers rely on the staff's 2005 statement that it would not deem a broker-dealer to exercise investment discretion for purposes of the then existing Advisers Act rule 202(a)(11)–1 as a result of the exercise of investment discretion by one of its associated persons over a ''related account''? [367]

• We are concerned that any approach to the broker-dealer exclusion in the Advisers Act that would permit broker-dealers unlimited investment discretion could increase incentives for improper conduct, particularly the incentive to churn accounts because broker-dealers receive transactional compensation. To what extent would permitting broker-dealers to exercise unlimited investment discretion increase the risk of such conduct? Are there protections in addition to those already in place, or limitations on the permissible use of investment discretion, that we could take to reduce such risks? To what extent would subparagraph (a)(2)(i)(C) of proposed Regulation Best Interest reduce such risks?

• To what extent does broker-dealers' exercise of investment discretion for their customers increase investor choice in financial services? What are the benefits and risks to investors? How could the risks be addressed through regulation, including Regulation Best Interest?

[366] 15 U.S.C. 78c(a)(35). Under Exchange Act Section 3(a)(35), a person exercises ''investment discretion'' with respect to an account if, ''directly or indirectly, such person (A) is authorized to determine what securities or other property shall be purchased or sold by or for the account, (B) makes decisions as to what securities or other property shall be purchased or sold by or for the account even through some other person may have responsibility for such investment decisions, or (C) otherwise exercises such influence with respect to the purchase and sale of securities or other property by or for the account as the Commission, by rule, determines, in the public interest or for the protection of investors, should be subject to the operation of the provisions of this title and the rules and regulations thereunder.''

[367] A ''related account'' is an account where the associated person's discretionary authority stems from his or her serving as executor, conservator, trustee, attorney-in-fact or other agent as a result of a family or personal relationship, and not from employment with the broker-dealer. No-Action Letter Under Investment Advisers Act of 1940—Rule 202(a)(11)–1 (Nov. 17, 2005), *available at https://www.sec.gov/divisions/investment/noaction/morganlewis111705.htm.*

• The Commission also requests commenters' views on potential opportunities for broker-dealers to offer discretionary brokerage services in the future. To what extent would broker-dealers anticipate offering additional discretionary brokerage services?

• As discussed in this release and the Relationship Summary Proposal, investors are often confused by the differences between advisory and brokerage accounts. Would drawing a specific distinction between discretionary and non-discretionary accounts resolve some of this confusion?

III. Request for Comment

The Commission requests comments on all aspects of Regulation Best Interest. The Commission particularly requests comment on the general impact the proposal would have on recommendations to retail customers and on the behavior of broker-dealers, including the interaction of Regulation Best Interest with the requirements of the Relationship Summary Proposal. The Commission also seeks comment on the interaction of Regulation Best Interest with FINRA and other SRO rules, the antifraud provisions of the federal securities laws, the Advisers Act, ERISA, and the Code. In addition, the Commission seeks comment on the following specific issues:

A. Generally

• Does Regulation Best Interest clearly define the obligations to which broker-dealers would be subject? Are there clarifications or instructions to the proposed requirements that would aid broker-dealers' compliance with the proposed rule? If so, what are they, and what would be the benefits of providing clarifications or instructions?

• As proposed, compliance with paragraph (a)(2) of Regulation Best Interest is designed to satisfy the duty in (a)(1). Is this the right relationship between these two pieces? Should paragraph (a)(2) be expressed as a minimum standard? Or should the duty in expressed in paragraph (a)(1) have residual force and effect apart from the obligations in (a)(2)? Alternatively, should compliance with (a)(2) be a safe harbor? Or should it create a legal presumption that the broker-dealer has met the standard in (a)(1)? Should the Commission create a compliance safe harbor for Regulation Best Interest? Why or why not? If so, what conditions should a broker-dealer be required to satisfy to claim the safe harbor? What impact would this have on the recommendations that retail customers receive?

• Should broker-dealers be subject to any additional requirements with respect to the best interest obligation proposed under Regulation Best Interest? If so, what requirements and why?

• Should the Commission require policies and procedures to assist with compliance with Regulation Best Interest? If so, how would those policies and procedures differ, if at all, from those currently required by FINRA?

• Should the Commission consider making other adjustments to the regulatory obligations of broker-dealers, and if so, which obligations?

• Should the Commission include in the rule text the interpretations and recommendations included in the guidance provided above? If so, which interpretations and recommendations and why or why not?

• Do commenters believe any of the proposed definitions under Regulation Best Interest should be eliminated or modified? Are there any additional terms that should be defined; if so, what are those terms, how should such terms be defined, and why?

• To what extent would Regulation Best Interest help address any investor confusion about the standard of conduct that applies when a broker-dealer provides advice in the form of recommendations? What, if any, other steps should the Commission consider to attempt to mitigate investor confusion?

• What impact would Regulation Best Interest have on the range of choice—both in terms of services related to advice and products—that is available to brokerage retail customers today? Would it preserve such choice? What, if any, additional or different steps should the Commission consider to attempt to preserve choice or mitigate any negative impact on the range of choice available to brokerage customers to receive financial advice?

• What impact would Regulation Best Interest have on the ability of broker-dealers to compete with other financial intermediaries to provide advice to investors in the future?

• To what extent would Regulation Best Interest be consistent with relevant SRO requirements? Would Regulation Best Interest be stricter or less strict than SRO obligations? Would Regulation Best Interest conflict with or be redundant of SRO obligations; if so, please identify which SRO obligations and whether and how the Commission should consider to address such conflicts or redundancies.

• Is it appropriate for Regulation Best Interest to be designed to be generally consistent with DOL and SRO regulations? Why or why not? Should we take a different approach?

• Does proposed Regulation Best Interest address current deficiencies in the current standard applicable to broker-dealers who provide advice? Why or why not? Please explain.

• Are there any recommendations in the 913 Study that should be, but have not been, incorporated into the proposed rule? Please elaborate.

• To what extent is the proposed Regulation Best Interest consistent or inconsistent with broker-dealers' existing obligations? How? What impact would such consistency or inconsistency have on retail customers and broker-dealers?

B. Interactions With Other Standards of Conduct

• Are there any specific interactions or relationships between the proposed rules and other federal securities laws that should be addressed?

• Are there any specific interactions between the proposed rules and other regulatory requirements, such as SRO rules or state securities laws that should be addressed?

• Are there any specific interactions between the proposed rules and any non-securities statutes and regulations (*e.g.,* ERISA and the Code) that should be addressed? If so, how should those interactions or relationships be addressed or clarified?

• Do any of the proposed requirements conflict with any existing requirements, including any requirement currently imposed by an SRO or by a state regulator, such that it would be impractical or impossible for a broker-dealer to meet both obligations? If so, which one(s) and why?

• Do commenters agree that proposed Regulation Best Interest is consistent with and similar to (if not the same as) related obligations under the duties of loyalty and care as interpreted under the Advisers Act? Why or why not? Please explain.

• If the Commission were to adopt this proposal, there would still be different standards of conduct for retail customer accounts subject to the DOL Fiduciary Rule and those that are not, as well as existing differences between standards of conduct applicable to broker-dealers and those applicable to investment advisers when providing investment advice. Should the Commission consider harmonizing regulatory obligations related to the provision of advice that are applicable to broker-dealers and investment advisers? Why or why not? If so, how so? Please be specific with regard to the existing obligations and how they should be changed.

• To what extent would regulatory harmonization address investors' confusion about the obligations owed to them by broker-dealers and investment advisers? To what extent would regulatory harmonization result in additional investor confusion or otherwise negatively impact investors? What would be positive and negative investor impacts of regulatory harmonization? To what extent would regulatory harmonization affect investors' choice of financial firms and options to pay for financial advice? Please explain.

• Are there any specific interactions between Regulation Best Interest and state standards that should be addressed? What have commenters' experiences been with respect to current state fiduciary standards (regulatory and common law) for broker-dealers that provide investment advice? How are these standards similar or different than this proposal? What are commenters' views regarding proposed state fiduciary standards for broker-dealers?

IV. Economic Analysis

A. Introduction, Primary Goals of Proposed Regulations and Broad Economic Considerations

1. Introduction and Primary Goals of Proposed Regulation

The Commission is mindful of the costs imposed by, and the benefits obtained from, our rules. Whenever the Commission engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, Section 3(f) of the Exchange Act requires the Commission to consider whether the action would promote efficiency, competition, and capital formation, in addition to the protection of investors.[368] Further, when making rules under the Exchange Act, Section 23(a)(2) of the Exchange Act requires the Commission to consider the impact such rules would have on competition.[369] Section 23(a)(2) of the Exchange Act also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[370] The following analysis considers, in detail, the potential economic effects that may result from proposed Regulation Best Interest, including the benefits and costs to retail customers and broker-dealers as well as the broader implications of the proposal for efficiency, competition, and capital formation.

Where possible, the Commission quantifies the likely economic effects of proposed Regulation Best Interest; however, as explained further below, the Commission is unable to quantify certain economic effects because it lacks the information necessary to provide reasonable estimates. In some cases, quantification is particularly challenging due to the difficulty of predicting how market participants would act under the conditions of the proposed rule. Nevertheless, as described more fully below, the Commission is providing both a qualitative assessment and quantified estimate of the potential effects, including the potential aggregate initial and aggregate ongoing costs, where feasible. The Commission encourages commenters to provide data and information to help quantify the benefits, costs, and the potential impacts of the proposed rule on efficiency, competition, and capital formation.

2. Broad Economic Considerations

a. The Principal-Agent Relationship

The relationship between a retail customer and a broker-dealer is an example of what is referred to in economic theory as an ''agency'' relationship. In an agency relationship, one party, commonly referred to as ''the principal,'' engages a second party, commonly referred to as ''the agent,'' to perform some service on the principal's behalf.[371] Because the agent and the principal are likely to have different preferences and goals, there is reason to believe that the agent may not always take actions that are in the principal's interest.[372] This divergence in interests gives rise to agency problems: Agents take actions that increase their well-being at the expense of principals.[373]

[368] *See* 15 U.S.C. 77b(b) and 15 U.S.C. 78c(f).

[369] *See* 15 U.S.C. 78w(a)(2).

[370] *Id.*

[371] For example, James A. Brickley, Clifford W. Smith, Jr., Jerold L. Zimmerman, ''Managerial Economics and Organizational Architecture'' (2004, p. 265), ''An agency relationship consists of an agreement under which one party, the principal, engages another party, the agent, to perform some service on the principal's behalf.'' *See also* Michael C. Jensen and William H. Meckling, ''Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,'' Journal of Financial Economics (1976, vol. 3, pp. 305–60).

[372] *See* Michael C. Jensen and William H. Meckling, ''Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,'' Journal of Financial Economics (1976, vol. 3, p. 308).

[373] *See* James A. Brickley, Clifford W. Smith, Jr., Jerold L. Zimmerman, ''Managerial Economics and Organizational Architecture'' (2004, p. 265).

Retail customers face agency problems when they seek advice from financial professionals. For example, a retail customer may believe that a broker-dealer will exert a high level of effort on a retail customer's behalf to identify a security that helps the retail customer meet her objectives. But to the extent that effort is costly to the broker-dealer and the benefits of the recommendation accrue solely to the retail customer, the broker-dealer has an incentive to exert a lower level of effort than the retail customer expects.[374] In this section, we describe how principals (customers) and agents (broker-dealers and associated persons) ameliorate agency problems in the market for investment advice using contracts and discuss limits to the efficiency of contracting in the market for financial advice.

Contracts are a common mechanism used by principals and agents to ameliorate agency problems. They do so by explicitly setting out the responsibilities of both parties under the contract. Typically, in return for compensation from the principal, an agent agrees to perform certain actions that will benefit the principal. For example, in a typical contract between a broker-dealer and a retail customer, the broker-dealer agrees to provide execution services in return for compensation in the form of either a commission or a markup. The contract ameliorates the conflict between the two parties because the broker-dealer is compensated only if it provides the contracted service.

Explicit contracting is an efficient mechanism for ameliorating agency costs when the principal can monitor the agent's performance at low cost. For certain services, however, it may be difficult or costly for principals to monitor agent performance. For example, in seeking investment advice, retail customers may expect broker-dealers to understand the potential risks and rewards associated with a recommended transaction or strategy. While it might be possible, in theory, to include such an explicit provision in the contract between the customer and the broker-dealer to this effect, it would be difficult for the customer to confirm the broker-dealer's actual understanding. The inability of the customer to confirm the broker-dealer's actual understanding limits the usefulness of such a provision in ameliorating the agency conflict between the customer and the broker-dealer.

Another factor that determines the effectiveness of explicit contracting and monitoring by the principal is the ability of the principal to accurately measure and assess the actions of the agent.[375] For example, customers may expect advice that is tailored to their specific investment objectives, financial situation, and needs. Contracts between customers and broker-dealers could include explicit provisions to this effect. However, customers may lack the knowledge required to assess whether a recommendation is appropriate for their needs, given their particular situation. As a result, while such an explicit provision could be included in a contract between a retail customer and a broker-dealer, it would be of limited value in ameliorating the agency conflict between the two.

Finally, we note that beyond the agency costs described above, there are costs associated with specifying the contractual terms themselves. Specifying contractual terms potentially involves forecasting all future states of the world that are relevant to the contractual relationship and specifying the parties' obligations in each of those states. In environments as complex as financial markets, the ability to forecast future states may be especially difficult. Further, even if financial firms and retail customers were able to forecast all future states of the world relevant to their relationship, the process of contractually specifying each state and the financial firm's obligation to a retail customer in each of those states could be very costly.[376]

As an alternative to explicit contracting and monitoring by principals, agents can expend resources (*i.e.,* ''bonding costs'') to guarantee their fulfillment of contractual terms or to ensure that the principal will be compensated if the agents fail to meet their obligations.[377] As we noted above, customers would like broker-dealers to understand the potential risks and rewards associated with a recommended transaction or strategy. For example, and if consistent with applicable legal limitations, the contract between the customer and broker-dealer could include a provision in which the broker-dealer agrees to compensate the retail customer if the broker-dealer does not have the level of understanding promised under the contract. Unfortunately, factors that limit the effectiveness of explicit contracting and monitoring by principals also tend to limit the effectiveness of explicit contracting and bonding by agents. For example, a broker-dealer's actual level of understanding is difficult to confirm. The difficulty in confirming a broker-dealer's understanding would cause any promise to compensate the customer if the broker-dealer did not understand the potential risks and rewards associated with a recommended transaction or strategy to be of limited value.

In situations where the costs of explicit contracting and monitoring and bonding are large, or where the cost of writing and enforcing contracts is large, a legal or regulatory standard of conduct can serve as an alternative mechanism for ameliorating agency costs.[378] Under a legal or regulatory standard of conduct, agents are obligated to act in the principal's interest with the standard of conduct defining how that obligation is to be met. For example, as noted above, retail customers would like broker-dealers to understand the potential risks and rewards associated with a recommended transaction or strategy as well as for the broker-dealer to tailor recommendations to the retail customer's specific investment objectives, financial situation, and needs. It would be difficult to stipulate those requirements in an explicit contract between a broker-dealer and a retail customer because such contract would be difficult to monitor and enforce. In particular, under private contracting, deterring broker-dealers from not acting in the retail customer's interest could be difficult. A standard of conduct that requires broker-dealers to act in the retail customer's best interest provides an alternative mechanism that is designed to result in the broker-dealer providing services at a level of quality

[374] Other manifestations of the agency conflict between broker-dealers and customers include conflicts that arise when broker-dealers act as principal (*e.g.,* proprietary products, principal trades) or when the broker-dealer opts to enter into relationships with third parties (*e.g.,* revenue sharing) that creates their own conflicts.

[375] *See* Frank H. Easterbrook and Daniel R. Fischel, ''Contract and Fiduciary Duty,'' Journal of Law & Economics (1993, vol. 36, p. 426) (''Contract and Fiduciary Duty'').

[376] *See* Frank H. Easterbrook and Daniel R. Fischel, ''The Economic Structure of Corporate Law'' (1991, p. 90). *See also* ''Contract and Fiduciary Duty.'' The authors note that parties to the contract are likely not able to see future possibilities well enough to specify all contingencies ahead of time.

[377] For example, agents might bond themselves by purchasing insurance policies that pay the principal in the case of theft. *See* James A. Brickley, Clifford W. Smith, Jr., Jerold L. Zimmerman, ''Managerial Economics and Organizational Architecture'' (2004, p. 265). The agent is willing to incur bonding costs to increase the amount paid to the agent by the principal for the agent's services.

[378] In a world of scarce information and high transactions costs, regulation can promote the efficiency of contracting between parties by prescribing the outcomes the parties themselves would have reached had information been plentiful and negotiations costless. *See* ''Contract and Fiduciary Duty'' and R. H. Coase, ''The Problem of Social Cost,'' Journal of Law & Economics (1960, vol. 3, pp. 1–44).

that better matches the expectations of its retail customers. In particular, broker-dealers would face regulatory liability if they failed to meet their obligation to act in the retail customer's interest under the standard of conduct. Relative to private contracting, a standard of conduct may be more effective in deterring broker-dealers from acting in their own interest rather than the retail customer's interest.

Regulation Best Interest would create a minimum professional standard of conduct for broker-dealers under the Exchange Act that is designed to ameliorate the agency costs associated with conflicts between broker-dealers and their retail customers. It would also articulate the role of regulators in enforcing such standard of conduct. As a result, the firm's legal and regulatory obligations would be designed to result in the firm providing advice at a level of quality that better matches the expectations of its retail customers.

In the absence of some form of amelioration, the agency conflicts between broker-dealers and retail customers may influence the advice that retail customers obtain in a number of ways. In the narrow context of a choice between two products with similar expected returns and risk profiles, but with different commissions, an agency conflict leaves the retail customer no worse off in terms of investment outcomes except to the extent that higher commissions result in total returns that are lower on one product than on the other. Under other circumstances, however, an agency conflict may impose greater or different costs on retail customers and, more generally, on financial markets.

For example, a financial firm that is able to systematically choose a higher fee product to recommend to its retail customers may rationally respond by constructing a menu of offerings that permit it to choose to recommend products that yield the firm higher expected payoffs. However, such menus may restrict retail customer access to financial products that are equally suitable but that could provide retail customers with better risk-return profiles. Agency conflicts that arise from material conflicts of interest may similarly cause financial firms to limit the choices available to retail customers. Financial firms may have incentives to prefer proprietary products or products of affiliates over more conventional products that may be equally suitable for the retail customers, but potentially more beneficial for the firms.

Furthermore, the ability of financial firms to act on conflicts may have repercussions for retail customer welfare if it erodes retail customer trust in financial markets or the market for financial advice. As noted in the Relationship Summary Proposal, evidence suggests a relatively low level of financial literacy among retail customers.[379] Retail customers who are aware that financial firms are likely to be conflicted may choose not to seek advice even when conflicted advice would make them better off than no advice at all. If the presence of conflicts of interest reduces retail customer trust, retail customers, out of abundance of caution may forgo valuable investment opportunities.[380] By contrast, disclosure of conflicts of interest and disclosure of measures taken to mitigate conflicts of interest could have the opposite effect by bolstering investor trust.

b. Effects of the Best Interest Standard on the Agency Relationship

As discussed above, there are significant investor protections offered by a best interest standard of conduct approach to addressing the principal-agent issue. However, it is important to note that both parties potentially benefit from the reduction of agency costs. As an initial matter, both retail customers and financial firms enter into an agency relationship only when both sides expect the relationship will make them better off. Generally, both parties enter into a contracting relationship when the retail customer values the financial firm's services at a value that is greater than the minimum price at which the financial firm is willing to supply them (the financial professional's ''reservation price'').[381] The difference between the retail customer's willingness to pay and the financial firm's reservation price represents the ''gains from trade'' associated with the contracting relationship. How these gains from trade are shared between the retail customer and the broker-dealer depends on a variety of factors, including the competitiveness of the market for financial advice, and the ability of broker-dealers to exploit their informational advantage over retail customers.

To make this concrete, consider a situation where a principal values the agent's services at $10,000 and the minimum price at which the agent is willing to provide the service is $5,000.[382] The difference between the principal's valuation of the agent's services and the minimum price at which the agent is willing to supply the services represents potential gains from trade to be shared between the two parties. In this case, the gains from trade would be $5,000 (=$10,000 − $5,000).[383]

Suppose, however, that the principal recognizes that the agent's preferences are not perfectly aligned with her own and that given the difference in preferences the principal revises her expectation of the agent's behavior, and therefore the valuation of the agent's services, to $7,000. The potential gains from trade have been reduced from $5,000 to $2,000. The $3,000 reduction in gains from trade is a real cost of the agency conflict between the two parties.[384] If gains from trade are shared between both parties, both parties have an incentive to ameliorate the agency conflict so as to maximize the potential gains from trade to be shared between the two.

Suppose further that the two parties could agree to a contract with explicit provisions that would ameliorate the agency conflict to such a degree that the principal would believe the agent's services to be worth $9,000. Further, suppose that the contract has associated costs of $500.[385] It would be in both parties' interests to use the contract because it would increase the gains from trade to be shared between the two from $2,000 to $3,500 (=$9,000 − $5,000 − $500).

However, contracts may be inefficient under certain circumstances. For example, suppose there existed additional contract provisions that could further ameliorate the agency conflict to a degree that the principal would believe that the agent's services to be worth an additional $500, or $9,500 in total (=$9,000 + $500), but that those provisions cost $750 to implement. In this case, it would not be in the parties' interests to engage in those additional contracting provisions

[379] *See* Relationship Summary Proposal. *See, e.g.,* Staff of the Securities and Exchange Commission, *Study Regarding Financial Literacy Among Investors As Required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Aug. 2012), at iv, v, xiv, 37, 73, 121–23 and 131–32, *available at https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf* (''917 Financial Literacy Study'')

[380] *See* Ko, K. Jeremy, ''Economics Note: Investor Confidence,'' Oct. 2017, *available at https://www.sec.gov/files/investor_confidence_noteOct2017.pdf*.

[381] *See* James A. Brickley, Clifford W. Smith, Jr., Jerold L. Zimmerman, ''Managerial Economics and Organizational Architecture'' (2004, p. 45).

[382] These numbers are provided only as an illustrative example and are not meant to convey the costs of financial services.

[383] *See supra* note 380.

[384] From the example, it should be clear that agency costs can, potentially, rise to such a level that the gains from trade are completely wiped out and trade does not occur.

[385] That is, the sum of the monitoring, bonding, and contract specifications costs is $500.

because it would result in a reduction in gains from trade from $3,500 to $3,250 (=$9,500 − $5,000 − $500 − $750).

Importantly, this example does not reflect the types of factors that can impact how these gains from trade will be shared. For example, broker-dealers may have an informational advantage that could allow them to maintain a large share of the gains of trade that flow from their relationship with retail customers. We understand that retail customers generally do not know the structure of mutual fund fees or how much is remitted back to broker-dealers recommending those funds. The proposed rule would no longer make it possible for the broker-dealer to make a recommendation solely based on the portion of fees that flow back to the broker-dealer, thereby reducing the share of the gains from trade that broker-dealers are currently able to retain. In response, broker-dealers may try to recoup this loss by increasing the fees for recommendations to retail customers. Fees that broker-dealers charge to retail customers, unlike the compensation that broker-dealers extract from product sponsors, are generally required to be disclosed. To the extent that retail customers are sensitive to fee increases (*e.g.,* may switch to another, lower-cost broker-dealer) broker-dealers may not be able to reverse the loss in gains from trade through a fee increase. Thus, the degree of competition among broker-dealers may limit the extent to which a broker-dealer can recoup these losses. As a result, if the market for broker-dealer advice is sufficiently competitive, the gains from trade that result from the proposed rule would mostly flow to retail customers.

Therefore, a standard of conduct may be an efficient alternative to the costly explicit contracting illustrated above. We acknowledge, however, that standards also can be costly. In the analysis that follows in Section C below, we characterize the benefits and costs associated with the proposed best interest standard of conduct and their resulting effect on the gains from trade to be shared between broker-dealers and their retail customers.

B. Economic Baseline

1. Market for Advice Services [386]

a. Broker-Dealers

The Commission analyzed the effect of proposed Regulation Best Interest on the market for broker-dealer services. For simplification, the Commission presents its analysis as if the market for broker-dealer services encompasses one broad market with multiple segments, even though, in terms of competition, it may be more realistic to think of it as numerous interrelated markets. The market for broker-dealer services covers many different markets for a variety of services, including, but not limited to, managing orders for customers and routing them to various trading venues; providing advice to retail customers on an episodic, periodic, or ongoing basis; holding retail customers' funds and securities; handling clearance and settlement of trades; intermediating between retail customers and carrying/clearing brokers; dealing in government bonds; privately placing securities; and effecting transactions in mutual funds that involve transferring funds directly to the issuer. Some broker-dealers may specialize in just one narrowly defined service, while others may provide a wide variety of services.

As of December 2017, there were approximately 3,841 registered broker-dealers with over 130 million customer accounts. In total, these broker-dealers have close to $4 trillion in total assets, which are total broker-dealer assets as reported on Form X–17a-5.[387] More than two-thirds of all brokerage assets and close to one-third of all customer accounts are held by the 16 largest broker-dealers, as shown in Table 1, Panel A.[388] Of the broker-dealers registered with the Commission as of December 2017, 366 broker-dealers were dually-registered as investment advisers;[389] however, these firms hold nearly 90 million (68% of) customer accounts.[390] Approximately 546 broker-dealers (14%) reported at least one type of non-brokerage business, including insurance, retirement planning, mergers & acquisitions, and real estate, among others.[391] Approximately 74% of registered broker-dealers report retail customer activity.[392]

Panel B of Table 1 limits the broker-dealers to those that report some retail customer activity. As of December 2017,

[386] In addition to broker-dealers and Commission-registered investment advisers discussed below in the baseline, there are a number of other entities, such as state registered investment advisers, commercial banks, and insurance companies, which also provide financial advice services to retail customers. A number of broker-dealers (*see infra* note 391) have non-securities businesses, such as insurance or tax services; however, the Commission is unable to estimate the number of other entities that are likely to provide financial advice to retail customers. As of January 2018, there were approximately 17,800 state-registered investment advisers, of which 145 are also registered with the Commission, as reported on Form ADV Item 2.A. The Department of Labor in its Regulatory Impact Analysis identifies approximately 398 life insurance companies that could provide advice to retirement investors. *See infra* note 453.

[387] Assets are estimated by Total Assets (allowable and non-allowable) from Part II of the FOCUS filings (Form X–17A–5 Part II, *available at https://www.sec.gov/files/formx-17a-5_2.pdf*) and correspond to balance sheet total assets for the broker-dealer. The Commission does not have an estimate of the total amount of customer assets for broker-dealers. We estimate broker-dealer size from the total balance sheet assets as described above.

[388] Approximately $3.91 trillion of total assets of broker-dealers (98%) are at firms with total assets in excess of $1 billion. Of the 30 dual registrants in the group of broker-dealers with total assets in excess of $1 billion, total assets for these dual registrants are $2.46 trillion (62%) of aggregate broker-dealer assets. Of the remaining 88 firms, 81 have affiliated investment advisers.

[389] Because this number does not include the number of broker-dealers who are also registered as state investment advisers, it undercounts the full number of broker-dealers that operate in both capacities. Further, not all firms that are dually-registered as an investment adviser and a broker-dealer offer both brokerage and advisory accounts to retail investors—for example, some dual registrants offer advisory accounts to retail investors but offer brokerage services, such as underwriting services, only to institutional customers. For purposes of the discussion of the baseline in this economic analysis, a dual registrant is any firm that is dually-registered with the Commission as an investment adviser and a broker-dealer. For the purposes of proposed Regulation Best Interest, however, we propose to define dual registrant as a firm that is dually-registered as a broker-dealer and an investment adviser and offers services to retail investors as both a broker-dealer and investment adviser.

[390] Some broker-dealers may be affiliated with investment advisers without being dually-registered. From Question 10 on Form BD, 2,145 broker-dealers (55.8%) report that directly or indirectly, they either control, are controlled by, or under common control with an entity that is engaged in the securities or investment advisory business. Comparatively, 2,478 (19.57% of) SEC-registered investment advisers report an affiliate that is a broker-dealer in Section 7A of Schedule D of Form ADV, including 1,916 SEC-registered investment advisers that report an affiliate that is a registered broker-dealer. Approximately 75% of total assets under management of investment advisers is managed by these 2,478 investment advisers.

[391] We examined Form BD filings to identify broker-dealers reporting non-securities business. For the 546 broker-dealers reporting such business, staff analyzed the narrative descriptions of these businesses on Form BD, and identified the most common types of businesses: Insurance (208), management/financial/other consulting (101), advisory/retirement planning (80), mergers & acquisitions (71), foreign exchange/swaps/other derivatives (31), real estate/property management (31), tax services (15), and other (141). Note that a broker-dealer may have more than one line of non-securities business.

[392] The value of customer accounts is not available from FOCUS data for broker-dealers. Therefore, to obtain estimates of firm size for broker-dealers, we rely on the value of broker-dealers' total assets as obtained from FOCUS reports. Retail sales activity is identified from Form BR, which categorizes retail activity broadly (by marking the ''sales'' box) or narrowly (by marking the ''retail'' or ''institutional'' boxes as types of sales activity). We use the broad definition of sales as we preliminarily believe that many firms will just mark ''sales'' if they have both retail and institutional activity. However, we note that this may capture some broker-dealers that do not have retail activity, although we are unable to estimate that frequency. We request comment on whether firms that intermediate both retail and institutional customer activity generally market only ''sales'' on Form BR.

there were approximately 2,857 broker-dealers that served retail customers, with over $3.6 trillion in assets (90 of total broker-dealer assets) and almost 128 million (96 of) customer accounts.[393] Of those broker-dealers serving retail customers, 360 are dually-registered as investment advisers.[394]

TABLE 1, PANEL A—REGISTERED BROKER-DEALERS AS OF DECEMBER 2017 [395]
CUMULATIVE BROKER-DEALER TOTAL ASSETS AND CUSTOMER ACCOUNTS [396]

Size of broker-dealer (total assets)	Total number of BDs	Number of dual-registered BDs	Cumulative total assets (billion)	Cumulative number of customer accounts [397]
> $50 billion	16	10	$2,717	40,969,187
$1 billion to $50 billion	102	20	1,196	81,611,933
$500 million to $1 billion	38	7	26	4,599,330
$100 million to $500 million	118	26	26	1,957,981
$10 million to $100 million	482	94	17	2,970,133
$1 million to $10 million	1,035	141	4	233,946
< $1 million	2,055	68	1	5,588
Total	3,841	366	3,987	132,348,098

TABLE 1, PANEL B—REGISTERED RETAIL BROKER-DEALERS AS OF DECEMBER 2017
CUMULATIVE BROKER-DEALER TOTAL ASSETS AND CUSTOMER ACCOUNTS

Size of broker-dealer (total assets)	Total number of BDs	Number of dual-registered BDs	Cumulative total assets (billion)	Cumulative number of customer accounts
> $50 billion	15	10	$2,647	40,964,945
$1 billion to $50 billion	70	19	923	77,667,615
$500 million to $1 billion	23	7	16	4,547,574
$100 million to $500 million	93	25	20	1,957,981
$10 million to $100 million	372	94	14	2,566,203
$1 million to $10 million	815	139	3	216,158
< $1 million	1,469	66	.4	5,588
Total	2,857	360	3,624	127,926,064

As shown in the table below, based on responses to Form BD, broker-dealers' most significant business lines include private placements of securities (61.4 of broker-dealers), retail sales of mutual funds (54.2), acting as a broker or dealer retailing corporate equity securities over the counter (51.2), acting as a broker or dealer retailing corporate debt securities (46.6), acting as a broker or dealer selling variable contracts, such as life insurance or annuities (39.5), acting as a broker of municipal debt/bonds or U.S. government securities (39.0 and 36.7, respectively), acting as an underwriter or selling group participant of corporate securities (30.0), investment advisory services (24.2), among others.[398]

TABLE 2—RETAIL BROKER-DEALER LINES OF BUSINESS AS OF DECEMBER 2017

Line of business	Total	
	Number of broker-dealers	Percent
Private Placements of Securities	1,755	61.4

[393] Total assets and customer accounts for broker-dealers that serve retail customers also include institutional accounts. Data available from Form BD and FOCUS data is not sufficiently granular to identify the percentage of retail and institutional accounts at firms.

[394] Of the 36 dual registrants in the group of retail broker-dealers with total assets in excess of $500 million, total assets for these dual registrants are $2.19 trillion (60%) of aggregate retail broker-dealer assets. Of the remaining 72 retail broker-dealers, 67 have affiliated investment advisers.

[395] The data is obtained from FOCUS filings as of December 2017. Note that there may be a double-counting of customer accounts among in particular the larger broker-dealers as they may report introducing broker-dealer accounts as well in their role as clearing broker-dealers.

[396] In addition to the approximately 130 million individual accounts at broker-dealers, there are approximately 293,000 omnibus accounts (0.2% of total accounts at broker-dealers), with total assets of $23.1 billion, across all 3,841 broker-dealers, of which approximately 99% are held at broker-dealers with greater than $1 billion in total assets. *See also supra* note 388. Omnibus accounts reported in FOCUS data are the accounts of non-carrying broker-dealers with carrying broker-dealers. These accounts may have securities of multiple customers (of the non-carrying firm), or securities that are proprietary assets of the non-carrying broker-dealer. We are unable to determine, from the data available, how many customer accounts non-carrying broker-dealers may have. The data does not allow the Commission to parse the total assets in those accounts to determine to whom such assets belong. Therefore, our estimate may be underinclusive of all customer accounts held at broker-dealers.

[397] "Customer Accounts" includes both broker-dealer and investment adviser accounts for dual registrants.

[398] Form BD requires applicants to identify the types of business engaged in (or to be engaged in) that accounts for 1% or more of the applicant's annual revenue from the securities or investment advisory business. Table 2 provides an overview of the types of businesses listed on Form BD, as well as the frequency of participation in those businesses by registered broker-dealers as of December 2017.

TABLE 2—RETAIL BROKER-DEALER LINES OF BUSINESS AS OF DECEMBER 2017—Continued

Line of business	Total	
	Number of broker-dealers	Percent
Mutual Fund Retailer	1,549	54.2
Broker or Dealer Retailing:		
Corporate Equity Securities OTC	1,462	51.2
Corporate Debt Securities	1,331	46.6
Variable Contracts	1,129	39.5
Municipal Debt/Bonds—Broker	1,115	39.0
U.S. Government Securities Broker	1,049	36.7
Put and Call Broker or Dealer or Options Writer	999	35.0
Underwriter or Selling Group Participant—Corporate Securities	857	30.0
Non-Exchange Member Arranging for Transactions in Listed Securities by Exchange Member	797	27.9
Investment Advisory Services	691	24.2
Broker or Dealer Selling Tax Shelters or Limited Partnerships—Primary Market	626	21.9
Trading Securities for Own Account	613	21.5
Municipal Debt/Bonds—Dealer	489	17.1
U.S. Government Securities—Dealer	347	12.1
Solicitor of Time Deposits in a Financial Institution	317	11.1
Underwriter—Mutual Funds	232	8.1
Broker or Dealer Selling Interests in Mortgages or Other Receivables	232	8.1
Broker or Dealer Selling Oil and Gas Interests	207	7.2
Broker or Dealer Making Inter-Dealer Markets in Corporate Securities OTC	205	7.2
Broker or Dealer Involved in Networking, Kiosk, or Similar Arrangements (Banks, Savings Banks, Credit Unions)	202	7.1
Internet and Online Trading Accounts	200	7.0
Exchange Member Engaged in Exchange Commission Business Other than Floor Activities	175	6.1
Broker or Dealer Selling Tax Shelters or Limited Partnerships—Secondary Market	163	5.7
Commodities	159	5.6
Executing Broker	111	3.9
Day Trading Accounts	92	3.2
Broker or Dealer Involved in Networking, Kiosk, or Similar Arrangements (Insurance Company or Agency)	90	3.2
Real Estate Syndicator	89	3.1
Broker or Dealer Selling Securities of Non-Profit Organizations	76	2.7
Exchange Member Engaged in Floor Activities	63	2.2
Broker or Dealer Selling Securities of Only One Issuer or Associate Issuers	47	1.6
Prime Broker	21	0.7
Crowdfunding FINRA Rule 4518(a)	18	0.6
Clearing Broker in a Prime Broker	14	0.5
Funding Portal	8	0.3
Crowdfunding FINRA Rule 4518(b)	3	0.1
Number of Retail-Facing Broker-Dealers	2,857	....

b. Investment Advisers

Proposed Regulation Best Interest could affect, indirectly, other providers of investment advice, such as investment advisers, because the proposed rule could impact the competitive landscape in the market for the provision of financial advice.[399] This section first discusses Commission-registered investment advisers, followed by a discussion of state-registered investment advisers.

As of December 2017, there were 12,659 investment advisers registered with the Commission. The majority of Commission-registered investment advisers report that they provide portfolio management services for individuals and small businesses.[400]

Of all SEC-registered investment advisers, 366 identified themselves as dually-registered broker-dealers.[401] Further, 2,478 investment advisers (20%) reported an affiliate that is a broker-dealer, including 1,916 investment advisers (15%) that reported an SEC-registered broker-dealer affiliate.[402] As shown in Panel A of Table 3 below, in aggregate, investment advisers have over $72 trillion in assets under management (''AUM''). A substantial percentage of AUM at investment advisers is held by institutional clients, such as investment companies, pooled investment vehicles, and pension or profit-sharing plans; therefore, although the dollar value of AUM for investment advisers and of customer assets in broker-dealer accounts is comparable, the total number of accounts for investment advisers is only 27% of the number of customer accounts for broker-dealers.

Based on staff analysis of Form ADV data, approximately 60% of investment advisers (7,600) have some portion of their business dedicated to individual clients, including both high net worth and non-high net worth individual clients,[403] as shown in Panel B of Table

[399] In addition to the Commission-registered and state-registered investment advisers, which are the focus of this section, the proposed rule could also affect banks, trust companies, insurance companies, and other providers of investment advice.

[400] Of the 12,659 SEC-registered investment advisers, 7,979 (64%) report in Item 5.G.(2) of Form ADV that they provide portfolio management services for individuals and/or small businesses. In addition, there are approximately 17,800 state-registered investment advisers, of which 145 are also registered with the Commission. Approximately 13,800 state-registered investment advisers are retail facing (*see* Item 5.D. of Form ADV).

[401] *See supra* note 389.

[402] Form ADV Item 7.A.1.

[403] We note that the data on individual clients obtained from Form ADV may not be exactly the same as who would be a ''retail customer'' as defined in proposed Regulation Best Interest because the data obtained from Form ADV is

3.[404] In total, these firms have approximately $32 trillion of assets under management.[405] Approximately 6,600 registered investment advisers (52%) serve 29 million non-high net worth individual clients and have approximately $5.33 trillion in assets under management, while nearly 7,400 registered investment advisers (58%) serve approximately 4.8 million high net worth individual clients with $6.56 trillion in assets under management.[406]

TABLE 3, PANEL A—REGISTERED INVESTMENT ADVISERS (RIAS) AS OF DECEMBER 2017 CUMULATIVE RIA ASSETS UNDER MANAGEMENT (AUM) AND ACCOUNTS

Size of investment adviser (AUM)	Number of RIAs	Number of dual-registered RIAs	Cumulative AUM (billion)	Cumulative number of accounts
> $50 billion	246	15	$48,221	17,392,968
$1 billion to $50 billion	3,238	115	21,766	11,560,805
$500 million to $1 billion	1,554	53	1,090	2,678,084
$100 million to $500 million	5,568	129	1,303	3,942,639
$10 million to $100 million	1,103	24	59	198,659
$1 million to $10 million	172	2	1	5,852
< $1 million	778	28	.02	31,291
Total	12,659	366	72,439	35,810,298

TABLE 3, PANEL B—RETAIL REGISTERED INVESTMENT ADVISERS (RIAS) AS OF DECEMBER 2017 CUMULATIVE RIA ASSETS UNDER MANAGEMENT (AUM) AND ACCOUNTS

Size of investment adviser (AUM)	Number of RIAs	Number of dual-registered RIAs	Cumulative AUM (billion)	Cumulative number of accounts
> $50 billion	106	15	$22,788	16,638,548
$1 billion to $50 billion	1,427	114	8,472	10,822,275
$500 million to $1 billion	934	52	652	2,602,220
$100 million to $500 million	4,114	126	917	3,814,900
$10 million to $100 million	711	24	40	231,663
$1 million to $10 million	98	1	.4	5,804
< $1 million	198	29	.02	31,271
Total	7,588	361	32,870	34,146,681

As an alternative to registering with the Commission, smaller investment advisers could register with state regulators.[407] As of December 2017, there were 17,635 state registered investment advisers,[408] of which 145 are also registered with the Commission. Of the state-registered investment advisers, 236 are dually-registered as broker-dealers, while 5% (920) report a broker-dealer affiliate. In aggregate, state-registered investment advisers have approximately $341 billion in AUM. Eighty-two percent of state-registered investment advisers report that they provide portfolio management services for individuals and small businesses, compared to just 64% for Commission-registered investment advisers.

Approximately 77% of state-registered investment advisers (13,470) have some portion of their business dedicated to retail investors,[409] and in aggregate, these firms have approximately $308 billion in AUM.[410] Approximately 12,700 (72%) state-registered advisers serve 616,000 non-high net worth retail clients and have approximately $125 billion in AUM, while over 11,000 (63%) state-registered advisers serve approximately 194,000 high net worth retail clients with $138 billion in AUM.[411]

limited to individuals and does not involve any test of use for personal, family, or household purposes.

[404] We use the responses to Items 5(D)(a)(1), 5(D)(a)(3), 5(D)(b)(1), and 5(D)(b)(3) of Part 1A of Form ADV. If at least one of these responses was filled out as greater than 0, the firm is considered as providing business to retail investors. Form ADV Part 1A.

[405] The aggregate AUM reported for these investment advisers that have retail investors includes both retail AUM as well as any institutional AUM also held at these advisers.

[406] Estimates are based on IARD system data as of December 31, 2017. The AUM reported here is specifically that of non-high net worth individual clients. Of the 7,600 investment advisers serving individual clients, 360 are also registered as broker-dealers.

[407] Pursuant to the Dodd-Frank Act, Item 2.A. of Part 1A of Form ADV requires an investment adviser to register with the SEC if it (i) is a large adviser that has $100 million or more of regulatory assets under management (or $90 million or more if an adviser is filing its most recent annual updating amendment and is already registered with the SEC); (ii) is a mid-sized adviser that does not meet the criteria for state registration or is not subject to examination; (iii) meets the requirements for one or more of the revised exemptive rules under section 203A discussed below; (iv) is an adviser (or subadviser) to a registered investment company; (v) is an adviser to a business development company and has at least $25 million of regulatory assets under management; or (vi) received an order permitting the adviser to register with the Commission. Although the statutory threshold is $100 million, the SEC raised the threshold to $110 million for those investment advisers that do not already file with the SEC.

[408] There are 79 investment advisers with latest reported Regulatory Assets Under Management in excess of $110 million but are not listed as registered with the SEC. For the purposes of this rulemaking, these are considered erroneous submissions.

[409] We use the responses to Items 5.D.(a)(1), 5.D.(a)(3), 5.D.(b)(1), and 5.D.(b)(3) of Part 1A of Form ADV. If at least one of these responses was filled out as greater than 0, the firm is considered as providing business to retail investors. Form ADV Part 1A.

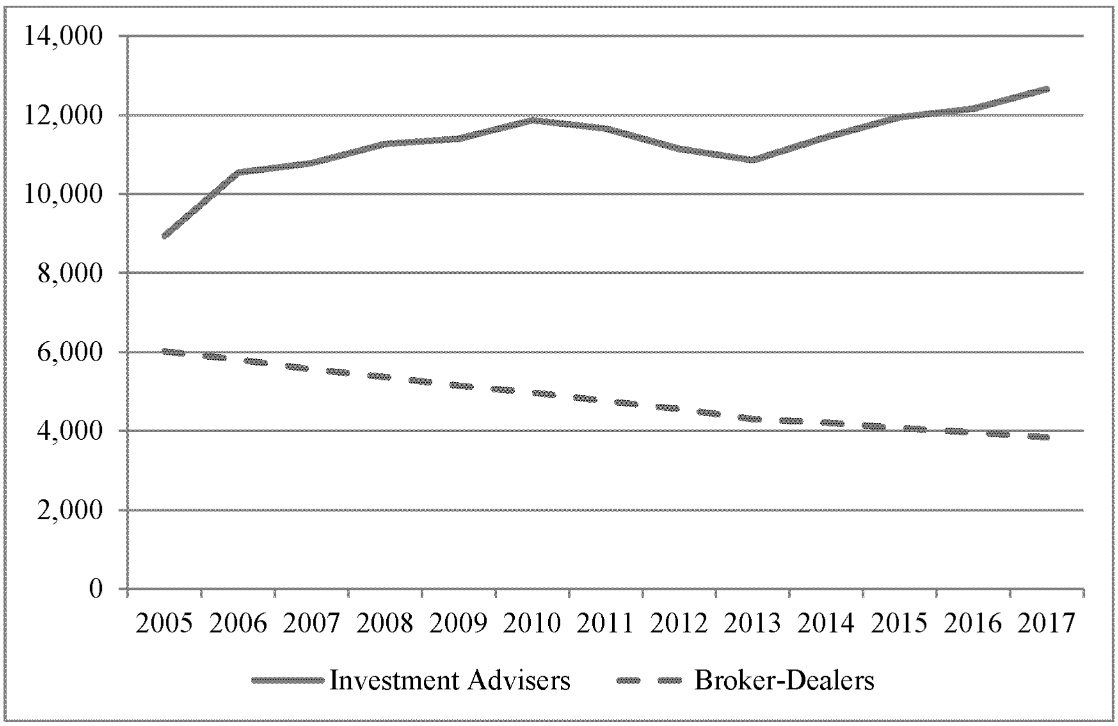
[410] The aggregate AUM reported for these investment advisers that have retail investors includes both retail AUM as well as any institutional AUM also held at these advisers.

[411] Estimates are based on IARD system data as of December 31, 2017. The AUM reported here is specifically that of non-high net worth investors. Of the 13,471 investment advisers serving retail investors, 144 may also be dually-registered as broker-dealers.

c. Trends in the Relative Numbers of Providers of Financial Services

Over time, the relative numbers of broker-dealers and Commission-registered investment advisers have changed. Figure 1 presented below shows the time series trend in the relative numbers of broker-dealers and Commission-registered investment advisers between 2005 and 2017. Over the last 13 years, the number of broker-dealers has declined from over 6,000 in 2005 to less than 4,000 in 2017, while the number of investment advisers has increased from approximately 9,000 in 2005 to over 12,000 in 2017. This change in the relative numbers of broker-dealers and investment advisers over time likely affects the competition for advice and potentially reduces the choices available to retail customers on how to receive or pay for such advice, the nature of the advice, and the attendant conflicts of interest.

Figure 1: Time Series of the Numbers of Investment Advisers and Broker-Dealers (2005 – 2017)



Increases in the number of investment advisers and decreases in the number of broker-dealers could have occurred for a number of reasons, including anticipation of possible regulatory changes to the industry, other regulatory restrictions, technological innovation (*i.e.,* robo-advisers and online trading platforms), product proliferations (*e.g.,* index mutual funds and exchange-traded products), and industry consolidation driven by economic and market conditions, particularly among broker-dealers.[412] Commission staff has observed the transition by broker-dealers from traditional brokerage services to providing also investment advisory services (often under an investment adviser registration, whether federal or state), and many firms have been more focused on offering fee-based accounts than accounts that charge commissions.[413] Broker-dealers have indicated that the following factors have contributed to this migration: Provision of stability or increase in profitability,[414] perceived lower

[412] *See* Hester Peirce, ''Dwindling numbers in the financial industry,'' Brookings Center on Markets and Regulation, May 15, 2017 (''Brookings Report''), *available at https://www.brookings.edu/research/dwindling-numbers-in-the-financial-industry/* (noting that ''SEC restrictions have increased by almost thirty percent [since 2000],'' and that regulations post-2010 were driven in large part by the Dodd-Frank Act). Further, the Brookings Report observation of increased regulatory restrictions on broker-dealers only reflects CFTC or SEC regulatory actions, but does not include regulation by FINRA, NFA, the MSRB, or other SROs.

[413] The Brookings Report also discusses the shift from broker-dealer to investment advisory business models for retail investors, in part due to the Department of Labor's fiduciary rule (page 7). *See also* the RAND Study, *supra* note 28, which documents a shift from transaction-based to fee-based accounts prior to recent regulatory changes. Declining transaction-based revenue due to declining commission rates and competition from discount brokerage firms has made offering fee-based products and services more attractive. Although discount brokerage firms generally provide execution-only services and do not compete directly in the advice market with full service broker-dealers and investment advisers, entry by discount brokers has contributed to lower commission rates throughout the broker-dealer industry. Further, fee-based activity generates a steady stream of revenue regardless of the customer trading activity, unlike commission-based accounts.

[414] Commission staff examined a sample of recent Form 10–K or Form 10–Q filings of large broker-dealers, many of which are dually-registered as investment advisers, that have a large fraction of retail customer accounts to identify relevant broker-dealers. *See, e.g.,* Edward Jones 9/30/2017 Form 10–Q, *available at https://www.sec.gov/Archives/edgar/data/815917/000156459017023050/ck0000815917-10q_20170929.htm*; Raymond James 9/30/2017 Form 10–K, *available at https://www.sec.gov/Archives/edgar/data/720005/000072000517000089/rjf-20170930x10k.htm*; Stifle 12/31/2016 Form 10–K, *available at https://www.sec.gov/Archives/edgar/data/720672/000156459017022758/sf-10q_20170930.htm*; Wells Fargo 9/30/2017 10–Q, *available at https://www.sec.gov/Archives/edgar/data/72971/000007297117000466/wfc-09302017x10q.htm*; and Ameriprise 12/31/2016 Form 10–K, *available at https://www.sec.gov/Archives/edgar/data/820027/000082002717000007/ameriprisefinancial12312016.htm.* We note that discussions in Form 10–K and 10–Q filings of this sample of broker-dealers may not be representative of other large broker-dealers or of small to mid-size

regulatory burden, and provisions of more or better services to retail customers.

Further, there has been a substantial increase in the number of retail clients at investment advisers, both high net worth clients and non-high net worth clients, as shown in Figure 2. Although the number of non-high net worth retail customers of investment advisers dipped between 2010 and 2012, since 2012, more than 12 million new non-high net worth retail clients have been added. With respect to assets under management, we observe a similar, albeit more pronounced pattern for non-high net worth retail clients as shown in Figure 3. For high net worth retail clients, there has been a pronounced increase in AUM since 2012, although AUM has leveled off since 2015.

Figure 2: Time Series of the Number of Retail Clients of Investment Advisers (2010 – 2017)

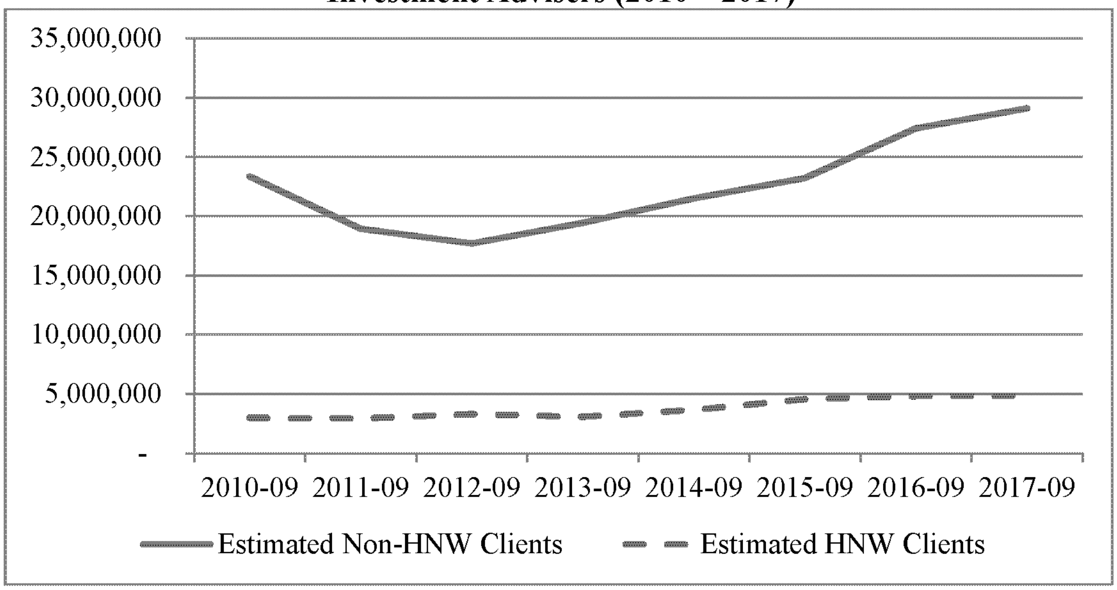
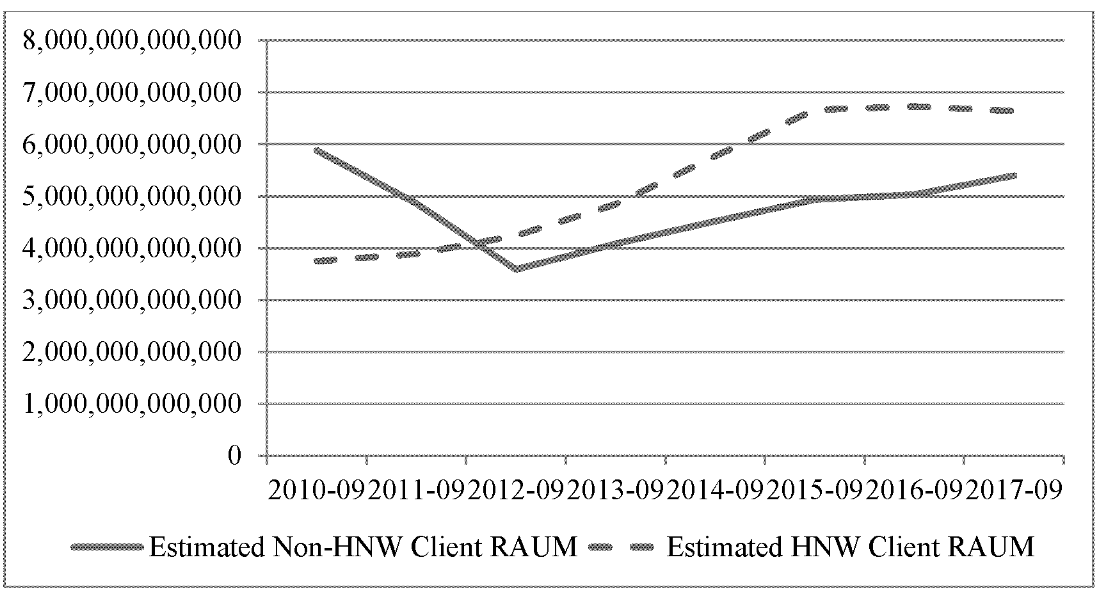


Figure 3: Time Series of the Retail Clients of Investment Advisers Assets under Management (2010 – 2017)



broker-dealers. Some firms have also reported record profits as a result of moving clients into fee-based accounts, and cite that it provides ''stability and high returns.'' *See* ''Morgan Stanley Wealth Management fees climb to all-time high,'' Bloomberg, Jan. 18, 2018, *available at https://www.bloomberg.com/news/articles/2018-01-18/morgan-stanley-wealth-management-fees-hit-record-on-stock-rally*. Morgan Stanley increased the percentage of client assets in fee-based accounts from 37% in 2013 to 44% in 2017, while decreasing the dependence on transaction-based revenues from 30% to 19% over the same time period (Morgan Stanley Strategic Update, Jan. 18, 2018, *available at https://www.morganstanley.com/about-us-ir/shareholder/4q2017-strategic-update.pdf*). See also Beilfuss, Lisa and Brian Hershberg, ''WSJ Wealth Adviser Briefing: The Reinvention of Morgan and Merrill, Adviser Profile,'' The Wall Street Journal, Jan. 25, 2018, *available at https://blogs.wsj.com/moneybeat/2018/01/25/wsj-wealth-adviser-briefing-the-reinvention-of-morgan-and-merrill-adviser-profile/*.

d. Registered Representatives of Broker-Dealers, Investment Advisers, and Dually-Registered Firms

We estimate the number of associated natural persons of broker-dealers through data obtained from Form U4, which generally is filed for individuals who are engaged in the securities or investment banking business of a broker-dealer that is a member of an SRO (''registered representatives'' or ''RR''s).[415] Similarly, we approximate the number of supervised persons of registered investment advisers through the number of registered investment adviser representatives (or ''registered IARs''), who are supervised persons of investment advisers who meet the definition of investment adviser representatives in Advisers Act Rule 203A–3 and are registered with one or more state securities authorities to solicit or communicate with clients.[416]

We estimate the number of registered representatives and registered IARs (together ''dually-registered representatives'') at broker-dealers, investment advisers, and dual-registrants by considering only the employees of those firms that have Series 6 or Series 7 licenses or are registered with a state as a broker-dealer agent or investment adviser representative.[417] We consider only employees at firms who have retail-facing business, as defined previously.[418] We observe in Table 5 that approximately 61% of registered financial professionals are employed by dually-registered entities. The percentage varies by the size of the firm. For example, for firms with total assets between $1 billion and $50 billion, 72% of all registered financial professionals in that size category are employed by dually-registered firms. Focusing on dually-registered firms only, approximately 59.7% of total licensed representatives at these firms are dually-registered, approximately 39.9% are only registered representatives; and less than 1% are only registered investment adviser representatives.

TABLE 5—TOTAL LICENSED REPRESENTATIVES AT BROKER-DEALERS, INVESTMENT ADVISERS, AND DUALLY-REGISTERED FIRMS WITH RETAIL CUSTOMERS[419]

Size of firm (total assets for standalone BDs and dually-registered firms; AUM for standalone IAs)	Total number of representatives	Percentage of representatives in dually-registered firms	Percentage of representatives in standalone BD	Percentage representatives in standalone IA
>$50 billion	82,668	75	8	18
$1 billion to $50 billion	150,662	72	10	18
$500 million to $1 billion	31,673	67	16	16
$100 million to $500 million	62,539	58	24	18
$10 million to $100 million	116,047	52	47	1
$1 million to $10 million	37,247	34	63	2
<$1 million	13,563	7	87	6
Total Licensed Representatives	494,399	61	27	12

In Table 6 below, we estimate the number of employees who are registered representatives, investment adviser representatives, or dually-registered representatives.[420] Similar to Table 5, we calculate these numbers using Form U4 filings. Here, we also limit the sample to employees at firms that have retail-facing businesses as discussed previously.[421]

In Table 6, approximately 24% of registered employees at registered broker-dealers or investment advisers are dually-registered representatives. However, this proportion varies significantly across size buckets. For example, for firms with total assets between $1 billion and $50 billion,[422] approximately 36% of all registered employees are dually-registered representatives. In contrast, for firms with total assets below $1 million, 15% of all employees are dual-hatted representatives.

[415] The number of associated natural persons of broker-dealers may be different from the number of registered representatives of broker-dealers, because clerical/ministerial employees of broker-dealers are associated persons, but are not required to register. Therefore, using the registered representative number does not include such persons. However, we do not have data on the number of associated natural persons and therefore are not able to provide an estimate of the number of associated natural persons. We believe that the number of registered representatives is an appropriate approximation because they are the individuals at broker-dealers that provide advice and services to customers.

[416] *See* Advisers Act Rule 203A–3. However, we note that the data on numbers of registered IARs may undercount the number of supervised persons of investment advisers who provide investment advice to retail investors because not all supervised persons who provide investment advice on behalf on an investment adviser are required to register as IARs. For example, Commission rules exempt from IAR registration supervised persons who provide advice only to non-individual clients or to individuals who meet the definition of ''qualified client,'' all of which individuals would fall under the definition of retail investor if they use the assets in advisory accounts for personal, family, or household purposes. *See id.* In addition, state securities authorities may impose additional criteria for requiring registration as an IAR.

[417] We calculate these numbers based on Form U4 filings. Broker-dealers, investment advisers, and issuers of securities must file this form when applying to register persons in certain jurisdictions and with certain SROs. Such firms and representatives generally have an obligation to amend and update information as changes occur. Using the examination information contained in the form, we consider an employee a financial professional if he has an approved, pending, or temporary registration status for either Series 6 or 7 (RR) or is registered as an investment adviser representative in any state or U.S. territory (IAR), although there are representatives that have passed exams other than the Series 7. We limit the firms to only those that do business with retail investors.

[418] *See supra* notes 392 and 404.

[419] The classification of firms as dually-registered, standalone broker-dealers, and standalone investment advisers comes from Forms BD, FOCUS, and ADV as described earlier. The number of representatives at each firm is obtained from Form U4 filings. Note that all percentages in the table have been rounded to the nearest whole percentage point.

[420] We calculated these numbers based on Form U4 filings.

[421] *See supra* notes 392 and 404.

[422] Firm size is measured by total firm assets from the balance sheet (source: FOCUS reports) for broker-dealers and dual registrants, and by assets under management for investment advisers (source: Form ADV). We are unable to obtain customer assets for broker-dealers, and for investment advisers, we can only obtain information from Form ADV as to whether the firm assets exceed $1 billion. We recognize that our approach of using firm assets for broker-dealers and customer assets for investment advisers does not allow for direct comparison; however, our objective is to provide measures of firm size and not to make comparisons between broker-dealers and investment advisers based on firm size. Across both broker-dealers and investment advisers, larger firms, regardless of whether we stratify on firm total assets or assets under management, have more customer accounts, are more likely to be dually-registered, and have more representatives or employees per firm, than smaller broker-dealers or investment advisers.

TABLE 6—NUMBER OF EMPLOYEES AT RETAIL-FACING FIRMS WHO ARE REGISTERED REPRESENTATIVES, INVESTMENT ADVISER REPRESENTATIVES, OR BOTH [423]

Size of firm (total assets for standalone BDs and dually-registered firms; AUM for standalone IAs)	Total number of employees	Percentage of dual-hatted representatives	Percentage of RRs only	Percentages of IARs only
>$50 billion	216,655	18	17	1
$1 billion to $50 billion	292,663	36	11	3
$500 million to $1 billion	50,531	15	40	6
$100 million to $500 million	112,119	23	24	8
$10 million to $100 million	189,318	19	41	1
$1 million to $10 million	61,310	19	39	1
< $1 million	19,619	15	46	3
Total Employees at Retail-Facing Firms	942,215	24	24	3

Approximately 88% of investment adviser representatives in Table 5 are dually-registered as registered representatives. This percentage is relatively unchanged from 2010. According to information provided in a FINRA comment letter in connection with the 913 Study, 87.6% of registered investment adviser representatives were dually-registered as registered representatives as of mid-October 2010.[424] In contrast, approximately 50% of registered representatives were dually-registered as investment adviser representatives at the end of 2017.[425]

e. Financial Incentives of Firms and Financial Professionals

Commission experience indicates that there is a broad range of financial incentives provided by standalone broker-dealers and dually-registered firms to their representatives.[426] While some firms provided a base pay for their financial professionals ranging from approximately $45,000 to $85,000 per year, many firms provided compensation only through a percentage of commissions, plus performance-based awards, such as individual or team bonus based on production. Commission-based payouts to financial professionals ranged from 30% to 95%, although these payouts were generally reduced by various costs and expenses attributable to the financial professional (*e.g.,* clearing costs associated with some securities, SRO or SIPC-related charges, and insurance, among others).

Several firms had varying commission payout rates depending on the product type being sold. For example, payouts ranged from 76.5% for stocks, bonds, options, and commodities to 90% for open-ended mutual funds, private placements, and unit investment trusts. Several firms charged varying commissions on products depending on the amount of product sold (*e.g.,* rates on certain proprietary mutual funds ranged from 0.75% to 5.75% depending on the share class), but did not provide those payout rates to financial professionals based on product type. Some firms also provided incentives for their financial professionals to recommend proprietary products and services over third-party or non-proprietary products. Commission rates for some firms, however, declined as the dollar amount sold increased and such rates varied across asset classes as well (*e.g.,* within a given share class, rates ranged from 1.50% to 5.75% depending on the dollar amount of the fund sold). With respect to compensation to individual financial professionals, if payout rates for mutual funds were approximately 90% (as discussed above, for example), financial professionals could earn between 0.68% and 5.18%, depending on the type and amount of product sold.

For financial professionals who did not earn commission-based compensation, some firms charged retail customers flat fees ranging from $500 to $2,500, depending on the level of service required, such as financial planning, while others charged hourly rates ranging from $150 to $350 per hour. For dually-registered firms that charged clients based on a percentage of assets under management, the average percentage charged varied based on the size of the account: The larger the assets under management, the lower the percentage fee charged. Percentage-based fees for the sample firms ranged from approximately 1.5% for accounts below $250,000 to 0.5% for accounts in excess of $1 million.[427] If payout rates range between 30% and 95%, a firm charging a customer $500 could provide compensation to the financial professional between $150 and $475 for each financial plan provided. For fee-based accounts, assuming that a retail customer had an account worth $250,000, the firm would charge fees of $3,750 ($250,000 × 1.5%), and the financial professional could earn between $1,170 and $3,560 annually for each account.

In addition to ''base'' compensation, most firms also provided bonuses (based on either individual or team performance) or variable compensation, ranging from approximately 10% to

[423] *See supra* notes 391, 403, 420, and 422. Note that all percentages in the table have been rounded to the nearest whole percentage point.

[424] FINRA comment letter to File Number 4–606; Obligations of Brokers, Dealers and Investment Advisers (Nov. 3, 2010), *available at https://www.sec.gov/comments/4-606/4606-2836.pdf*.

[425] In order to obtain the percentage of IARs that are dually-registered as registered representatives of broker-dealers, we sum the representatives at dually-registered entities and those at investment advisers, across size categories to obtain the aggregate number of representatives in each of the two categories. We then divide the aggregate dually-registered representatives by the sum of the dually-registered representatives and the IARs at investment adviser-only firms. We perform a similar calculation to obtain the percentage of registered representatives of broker-dealers that are dually-registered as IARs.

[426] Information on compensation and financial incentives generally relates to 2016 compensation arrangements for a sample of approximately 20 firms, comprised of both standalone broker-dealers and dually-registered firms. We acknowledge that the information provided in this baseline may not be representative of the compensation structures more generally because of the diversity and complexity of services and products offered by standalone broker-dealers and dually-registered firms.

[427] We note that some firms could have higher or lower commission payout rates or asset-based fee percentages than those provided here. For example, based on a review of Form ADV Part 2A (the brochure) of several large dual registrants (not included in the sample above), asset-based fees for low AUM accounts could range as high as 2.0% to 3.0%, with the average fee for high AUM accounts ranging between 0.5% to 1.5%. *See also* ''Average Financial Advisor Fees & Costs, 2017 Report, Understanding Advisory & Investment Management Fees,'' AdvisoryHQ, *available at http://www.advisoryhq.com/articles/financial-advisor-fees-wealth-managers-planners-and-fee-only-advisors/*. The AdvisoryHQ report shows that average asset-based fees range from 1.18% for accounts less than $50,000 to less than 0.60% for accounts in excess of $30 million, while fixed-fees range from $7,500 for accounts less than $500,000 to $55,000 for accounts in excess of $7.5 million. Again, we note that these are charges to clients and are not indicative of the total compensation earned by the financial professional per account.

83% of base compensation. While the majority of firms based at least some portion of their bonuses on production, usually in the form of total gross revenue, other forms of bonus compensation were derived from customer retention, customer experience, and manager assessment of performance. Moreover, some firms used a tiered system within their compensation grids depending on firm experience and production levels. Financial professionals' variable compensation could also increase when they enrolled retail customers in advisory accounts versus other types of accounts, such as brokerage accounts. Some firms also provided transition bonuses for financial professionals with prior work experience based on historical trailing production levels and AUM. Although many firms did not provide any incentive-based contests or programs, some firms awarded non-cash incentives for meeting certain performance, best practices, or customer service goals, including trophies, dinners with senior officers, and travel to annual meetings with other award winners.

2. Regulatory Baseline

Regulation Best Interest would require broker-dealers and natural persons associated with broker-dealers, when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer, to 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 the broker or dealer making the recommendation, ahead of the interest of the retail customer. Regulation Best Interest incorporates and goes beyond the existing broker-dealer regulatory regime for advice. In this section, we describe the existing regulatory baseline for broker-dealers, including existing obligations under the federal securities laws and FINRA rules, in particular those related to the suitability of recommendations and disclosure of conflicts of interest, state regulation, existing antifraud provisions, and state laws that impose fiduciary obligations, and other obligations that would be imposed by the DOL Fiduciary Rule and related PTEs, most notably the BIC Exemption.

a. Suitability Obligations

Under the antifraud provisions of the federal securities laws and SRO rules, broker-dealers are required to deal fairly with their customers. By virtue of engaging in the brokerage profession, a broker-dealer makes an implicit representation to those persons with whom it transacts business that it will deal fairly with them, consistent with the standards of the profession.[428] A central aspect of a broker-dealer's duty of fair dealing is the suitability obligation, which has been interpreted as requiring a broker-dealer to make recommendations that are consistent with the best interest of his customer under SRO rules.[429] The concept of suitability has been interpreted as an obligation under the antifraud provisions of the federal securities laws and also under specific SRO rules.[430] FINRA Rule 2111 (''Suitability'') requires that a broker-dealer or associated person have a reasonable basis to believe that a recommendation or investment strategy is ''suitable'' for the retail customer.[431] The suitability obligation is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of commercial conduct.[432]

Under FINRA Rule 2111, there are three primary suitability requirements for broker-dealers and associated persons. First, reasonable-basis suitability requires that, based on reasonable diligence, a broker-dealer must have a reasonable basis that a recommendation is suitable for at least some retail customers.[433] Second, customer-specific suitability requires that, based on a given customer's investment profile as detailed above, the broker-dealer has a reasonable basis to believe that the recommendation or investment strategy is suitable for that customer.[434] Finally, quantitative suitability requires that a broker-dealer must have a reasonable basis to believe that a series of recommended transactions is not excessive or unsuitable for a customer when taken together in light of the customer's investment profile, even if each individual recommendation is suitable in isolation.[435] Broker-dealers also have additional specific suitability obligations with respect to certain types of products or transactions, such as variable insurance products and non-traditional products, including structured products and leveraged and exchange-traded funds.[436]

b. Existing Broker-Dealer Disclosure Obligations

As described above, broker-dealers are subject to a number of specific disclosure obligations when they effect certain customer transactions, and are subject to additional disclosure obligations under the antifraud provisions of the federal securities laws.[437] Generally, under the antifraud provisions of the federal securities laws, a broker-dealer's duty to disclose material information to its customers depends on the scope of the relationship with the customer, which is fact intensive.[438] When making recommendations, broker-dealers may be held liable if they do not provide honest and complete information or do not disclose material conflicts of interest of which they are aware.[439] For example, in making recommendations, courts have found broker-dealers should have disclosed that they were: acting as a market maker for the recommended security; trading as a principal with respect to the recommended security; engaging in revenue sharing with a recommended mutual fund; or ''scalping'' a recommended security.[440]

In addition to the antifraud provisions of the federal securities laws, courts interpreting state common law have imposed fiduciary obligations on broker-dealers in certain circumstances. Generally, courts have found that broker-dealers that exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers, owe customers a fiduciary duty.[441] As discussed above, in developing proposed Regulation Best Interest, the Commission has drawn from state common law fiduciary principles, among other things, in order to establish greater consistency in the level of retail customer protections and to ease compliance with Regulation Best Interest where other legal regimes—such as state common law—might also apply. For instance, under proposed Regulation Best Interest, a broker-

[428] *See* 913 Study at 51; *see also Charles Hughes & Co.* v. *SEC,* 139 F.2d 434 (2d Cir. 1943), *cert. denied,* 321 U.S. 786 (1944).

[429] *See, e.g., In re Application of Raghavan Sathianathan,* Exchange Act Release No. 54722 at 21 (Nov. 8, 2006). *See also supra* note 15.

[430] *See Hanly* v. *SEC,* 415 F.2d 589, 596 (2d Cir. 1969).

[431] *See* FINRA Rule 2111.

[432] *See* FINRA Rule 2111.01.

[433] According to FINRA Rule 2111, reasonable diligence requires that the broker-dealer or the associated person understands the potential risks and rewards of the recommendation or the investment strategy.

[434] *Id.*

[435] *Id.*

[436] *See, e.g.,* FINRA Rule 2330, ''Members' Responsibilities Regarding Deferred Variable Annuities;'' FINRA Rule 2370, ''Securities Futures;'' *see also* 913 Study at 65–66.

[437] *See supra* notes 175–177 and 205 and accompanying text.

[438] *See supra* note 176.

[439] *Id.*

[440] *See* 913 Study at notes 251–54.

[441] *See supra* note 15.

dealer's duty to exercise reasonable diligence, care, skill, and prudence would resemble the standard of conduct that has been imposed on broker-dealers found to be acting in a fiduciary capacity under state common law.[442] Similarly, a broker-dealer's Disclosure Obligation (along with the Conflict of Interest Obligations) under proposed Regulation Best Interest would resemble the duty to disclose material conflicts imposed on broker-dealers found to be acting as fiduciaries under state common law.[443]

c. Department of Labor's Fiduciary Rule and Related Federal Securities Laws

DOL amendments to its regulation defining investment advice in the DOL Fiduciary Rule would broadly expand the types of broker-dealer services that may trigger fiduciary status for the purposes of the prohibited transaction provisions of ERISA and the Code as a result of rendering investment advice to retirement accounts.[444] As noted, in connection with the DOL Fiduciary Rule, DOL amended certain existing PTEs and adopted new PTEs, including in particular the BIC Exemption, which generally permits certain financial institutions including broker-dealers to recommend investment transactions and receive commissions and other compensation resulting from the recommended transactions under certain conditions.[445] As discussed above, a broker-dealer that wishes to rely on the BIC Exemption to engage in transactions that would otherwise be prohibited (*e.g.,* providing investment recommendations and receiving ''conflicted compensation'')—would have to adhere to the Impartial Conduct Standards (including obligations to provide ''best interest'' recommendations, receive no more than reasonable compensation, and avoid making statements that are materially misleading at the time they are made). Broker-dealers that seek to rely on the BIC Exemption would have to satisfy additional conditions including (among other things) that, as described above, require broker-dealers to (1) enter into a written contract with each IRA owner enforceable against the broker-dealer that acknowledges fiduciary status, commits to adhere to the Impartial Conduct Standards, and warrants to the adoption of certain policies and procedures, (2) implement policies and procedures reasonably designed to ensure that the firm and its advisers provide best interest advice and minimize the harmful impact of conflicts of interest in conflicts, including a prohibition against differential compensation or other incentives that were intended or expected to cause advisers to provide recommendations that are not in the customer's best interest, and (3) disclose information about fees, compensation and material conflicts of interest associated with recommendations in initial and ongoing disclosures, including website disclosures.[446]

Existing broker-dealer obligations under the federal securities laws and FINRA rules prohibit misleading statements and require fair and reasonable compensation. The antifraud provisions of the federal securities laws prohibit broker-dealers from making misleading statements,[447] while FINRA Rule 2210 specifically addresses communications between broker-dealers and the public and requires that these communications be based on principles of fair dealing and good faith and be fair and balanced.[448] Under FINRA rules, prices for securities and broker-dealer compensation are required to be fair and reasonable, taking into consideration all relevant circumstances.[449] Although the existing standards and rules identified above prohibit broker-dealers from making misleading statements, address their communications with the public, and require fair and reasonable compensation, the DOL also adopted the Impartial Conduct Standards to address these issues in the BIC Exemption.[450]

As discussed above, as a practical matter, broker-dealers offering IRA brokerage accounts would generally need to meet the conditions of the BIC Exemption or one of the related PTEs to make recommendations to brokerage customers with such accounts and receive commissions or other compensation relating to recommended transactions. To determine the universe of broker-dealers that offer IRA brokerage accounts and generally would need to meet the conditions of the BIC Exemption for purposes of this baseline, we assume that all broker-dealers that have retail accounts are required to comply with the PTEs, including the BIC Exemption, in providing services to at least some of their retail accounts. The Commission does not currently have data on the number of firms that would rely on these PTEs and that would be required to provide these disclosures.[451] However, the Commission can broadly estimate the maximum number of broker-dealers that would be subject to the requirements of the PTEs from the number of broker-dealers that have retail customer accounts. Approximately 74.4% (2,857) of registered broker-dealers report sales to retail customers.[452] Similarly, approximately 7,600 (60% of) investment advisers serve high net worth and non-high net worth individual clients. The Commission understands that these numbers are an upper bound and likely overestimates the broker-dealers and investment advisers that provide retirement account services.[453]

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[442] *See, e.g., Davis* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 906 F.2d 1206, 1215 (8th Cir. 1990) (finding that the district court did not abuse its discretion in instructing the jury that licensed securities brokers were fiduciaries that owed their customers a duty of utmost good faith, integrity, and loyalty).

[443] *See, e.g., United States* v. *Szur,* 289 F.3d 200, 212 (2d Cir. 2002) (broker's fiduciary relationship with customer gave rise to a duty to disclose commissions to customer, which would have been relevant to customer's decision to purchase stock); *Arleen W. Hughes,* Exchange Act Release No. 4048 (Feb. 18, 1948) (Commission Opinion), *aff'd sub nom. Hughes* v. *SEC,* 174 F.2d 969, 976 (D.C. Cir. 1949) (broker-dealer acted in the capacity of a fiduciary and, as such, broker-dealer was under a duty to make full disclosure of the nature and extent of her adverse interest, ''including her cost of the securities and the best price at which the security might be purchased in the open market'').

[444] *See* BIC Exemption Release, 81 FR at 21007 (DOL states that it ''anticipates that the [DOL Fiduciary Rule] will cover many investment professionals who did not previously consider themselves to be fiduciaries under ERISA or the Code.'').

[445] *See* BIC Exemption Release. Broker-dealers and their registered representatives are not, however, *required* to comply with conditions under the BIC Exemption if they adopt a different approach to avoid non-exempt prohibited transactions, including by meeting the conditions of the statutory exemption for the provision of investment advice to participants of individual account plans under ERISA sections 408(b)(14) and 408(g), or by offsetting third-party payments against level fees, see BIC Exemption Release, 81 FR at 21013, at n. 23 and accompanying text.

[446] *See* BIC Exemption Release, 81 FR at 21007. These conditions are discussed in more detail below.

[447] *See* Exchange Act Sections 10(b) and 15(c).

[448] *See* FINRA Rule 2210 (''Communications with the Public'').

[449] *See e.g.,* Exchange Act Sections 10(b) and 15(c); FINRA Rules 2121 (''Fair Prices and Commissions''), 2122 (''Charges for Services Performed''), and 2341 (''Investment Company Securities'').

[450] *See* BIC Exemption Release, 81 FR 21007, 21030–32.

[451] In order to perform this analysis, the Commission would need to know which financial firms have retirement-based assets as part of their business model. Under the current reporting regimes for both broker-dealers and investment advisers, they are not required to disclose whether (or what fraction of) their accounts are held by retail investors in retirement-based accounts.

[452] As of December 2017, 3,841 broker-dealers filed Form BD. Retail sales by broker-dealers were obtained from Form BR. *See supra* note 392.

[453] The Department of Labor Regulatory Impact Analysis (''DOL RIA'') identified approximately 4,000 broker-dealers (FINRA, 2016), of which approximately 2,500 are estimated to have either ERISA accounts or IRA associated with the broker-dealers, similar to the estimates that we provide

Continued

A recent survey and study were conducted to provide information about how the broker-dealer industry has begun to transition as a result of the DOL Fiduciary Rule. In 2017, the Securities Industry and Financial Markets Association (''SIFMA'') teamed with Deloitte and conducted a study focusing on the impact of the DOL Fiduciary Rule on retirement investors and financial institutions.[454] The SIFMA Study surveyed 21 SIFMA members and captured 43% of U.S. ''financial advisors'' (132,000 out of 310,000), 35 million retail retirement accounts,[455] and 27% of qualified retirement savings assets ($4.6 trillion out of $16.9 trillion).

Of the 21 SIFMA members that participated in the survey, 53% eliminated or reduced access to brokerage advice services and 67% have migrated away from open choice to fee-based or limited brokerage services. For those retail customers faced with eliminated or reduced brokerage advice services, 63% chose to move to self-directed accounts rather than fee-based accounts and cited the reasons as ''not wanting to move to a fee-based model, not in the best interest to move to a fee-based model, did not meet account minimums, or wanted to maintain positions in certain asset classes prohibited by the fee-based models.'' For those retail customers that migrated from brokerage to fee-based models, the average change in all-in fees increased by 141% from 46 basis points (bps) to 110 bps.

Further, 95% of survey participants altered their product offerings, by reducing or eliminating certain asset or share classes. For example, 86% of the respondents reduced the number or type of mutual funds (*e.g.,* 29% eliminated no-load funds, while 67% reduced the number of mutual funds), and 48% reduced annuity product offerings. Moreover, although the DOL Fiduciary Rule applies only in connection with services for retirement accounts, many of the survey participants have implemented the changes to both retirement and non-retirement accounts.[456]

To date, the survey participants have incurred compliance costs of $600 million, although the costs vary by the size of the respondent. For instance, large firms with net capital in excess of $1 billion are expected to have start-up and ongoing compliance costs of $55 million and $6 million, respectively, while firms between $50 million and $1 billion in net capital are expected to have start-up and ongoing compliance costs of $16 million and $3 million, respectively. The SIFMA Study estimates that total start-up compliance costs for large and medium-size firms combined will be approximately $4.7 billion, compared to the DOL's estimate of between $2 billion and $3 billion, while ongoing costs will be approximately $700 million per year (DOL's estimates between $463 million and $679 million annually).

C. Benefits, Costs, and Effects on Efficiency, Competition, and Capital Formation

In formulating Regulation Best Interest, the Commission has considered the potential benefits of establishing a best interest standard of conduct for broker-dealers and the potential costs to the firms and retail customers of complying with the best interest obligation.

The best interest standard of conduct for broker-dealers would enhance the quality of investment advice that broker-dealers provide to retail customers, help retail customers evaluate the advice received, and improve retail customer protection when soliciting advice from broker-dealers. By imposing a best interest obligation on broker-dealers, Regulation Best Interest would achieve these benefits by ameliorating the agency conflict between broker-dealers and retail customers. The three components of the best interest obligation, namely the Disclosure Obligation, the Care Obligation, and the Conflict of Interest Obligations work together towards ameliorating this agency conflict by addressing specific aspects of the conflict. In particular, these obligations, taken together, are meant to provide assurances to the retail customer that a broker-dealer provides a certain quality of recommendation that is consistent with the customer's best interest.

The Disclosure Obligation, as discussed above, would reduce the informational gap with respect to certain elements of the relationship that are not currently fully disclosed. In particular, this obligation would foster retail customer awareness and understanding of key broker-dealer practices as well as material conflicts of interest associated with broker-dealer recommendations that would ultimately improve a retail customer's assessment of the recommendations received.

The Care Obligation, as discussed above, is designed to result in the broker-dealer providing advice at a level of quality that better matches the expectations of retail customers, and, as a result, should enhance the quality of recommendations received.[457]

Proposed Regulation Best Interest would impose two concurrent Conflict of Interest requirements, as described above. These Conflict of Interest Obligations would enable broker-dealers to meet the Disclosure Obligation with regard to material conflicts of interest which would enhance customer understanding of broker-dealer conflicts associated with a recommendation and the extent to which those conflicts may influence a recommendation. This enhanced understanding of broker-dealer conflicts would aid retail customers in assessing, and deciding whether to act on, broker-dealer recommendations. Taken together, the Disclosure Obligation, the Care Obligation and the Conflict of Interest Obligations are designed to reduce the effects of conflicted broker-dealer advice and thereby improve retail customer protection.

above. In addition to broker-dealers, the DOL RIA estimates that other providers of ERISA or IRA accounts include: Approximately 10,600 federally registered investment advisers and 17,000 state-registered investment advisers (NASAA 2012/2013 Report), of which approximately 17,000 of federal and state investment advisers that are not dual registered, approximately 6,000 ERISA plan sponsors (2013 Form 5500 Schedule C), and approximately 400 life insurance companies (2014 SNL Financial Data). *See* The Department of Labor, Regulating Advice Markets: Regulatory Impact Analysis for Final Rule and Exemptions (Apr. 2016), *available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf.*

[454] *See* The DOL Fiduciary Rule: A study on how financial institutions have responded and the resulting impacts on retirement investors, SIFMA and Deloitte (Aug. 9, 2017), *available at https://www.sifma.org/wp-content/uploads/2017/08/Deloitte-White-Paper-on-the-DOL-Fiduciary-Rule-August-2017.pdf* (''SIMFA Study'').

[455] The types of retirement accounts serviced by the participants in the SIFMA Study were not defined.

[456] In July 2017, the American Bankers Association (''ABA'') conducted a survey of 57 banks about their understanding of the Fiduciary Rule on products and the impact of the rule on products and services available to retirement investors. None of the survey respondents added to the retirement products or services available, while 30% eliminated or reduced products or services available to retirement investors in response to the Fiduciary Rule. Nearly 40% of banks further believed that the relationship with their customers has been altered as a result of the Fiduciary Rule applying only to retirement assets ''since the bank is unable to provide holistic financial advice to its customers.'' *available at https://www.aba.com/Advocacy/Issues/Documents/dol-fiduciary-rule-survey-summary-report.pdf. See* ''Department of Labor Fiduciary Rule: National Survey of Financial Professionals'' Financial Services Roundtable/Harper Polling (July 2017), *available at http://www.fsroundtable.org/wp-content/uploads/2017/08/17.07-FSR-Presentation-1.pdf.* We note that the developments of business models and practices discussed herein reflect changes made voluntarily by firms in response to the DOL Fiduciary Rule, but were not necessarily required by the DOL Fiduciary Rule.

[457] *See supra* Section IV.D.2.

The Commission acknowledges, however, that Regulation Best Interest, through its component obligations, would potentially give rise to direct costs to broker-dealers and indirect costs to retail customers. For example, the requirement to act in the retail customer's best interest of the Care Obligation may lead some broker-dealers to determine that they no longer wish to make certain recommendations, and, as a result, may forgo some of the revenue stream associated with such recommendations. The disclosure requirements of the Disclosure Obligation and the Conflict of Interest Obligations would go beyond existing disclosure obligations, and, as a result, may impose direct costs on broker-dealers. Certain aspects of the Conflict of Interest Obligations may decrease the incentives of registered representatives to expend effort in providing quality advice, and, therefore, may impose a cost on retail customers if there is a decline in the quality of recommendations. Finally, other aspects of the Conflict of Interest Obligations may limit retail customer choice and, therefore, impose costs on retail customers, because broker-dealers, for compliance or business reasons, may determine to avoid certain products, despite the fact that those products may be beneficial to certain retail customers in certain circumstances.

Although, in establishing a best interest obligation for broker-dealers, the Commission considers these and other potential benefits and costs, the Commission notes that generally it is difficult to quantify such benefits and costs. Several factors make the quantification of the effects of the best interest obligation difficult. There is a lack of data on the extent to which broker-dealers with different business practices engage in disclosure and conflict mitigation activities to comply with existing requirements, and therefore how costly it would be to comply with the proposed requirements. The proposed rule would also give broker-dealers flexibility in complying with the best interest obligation, and, as a result, there could be multiple ways in which broker-dealers could satisfy this obligation, so long as it complies with its baseline obligations. Finally, any estimate of the magnitude of such benefits and costs would depend on assumptions about the extent to which broker-dealers are currently engaging in disclosure and conflict mitigation activities, how broker-dealers would choose to satisfy the best interest obligation, and, potentially, how retail customers perceive the risk and return of their portfolio, the likelihood of acting on a recommendation that complies with the best interest obligation, and how the risk and return of their portfolio change as a result of how they act on the recommendation. Since the Commission lacks the data that would help narrow the scope of these assumptions, the resulting range of potential quantitative estimates would be wide and, therefore, not informative about the magnitude of the benefits or costs associated with the best interest obligation.

1. Benefits

In this section, we discuss the benefits of a best interest standard of conduct, generally, and the benefits associated with the components of Regulation Best Interest, specifically.

Proposed Regulation Best Interest would create an express best interest obligation under the Exchange Act that consists of three components: The Disclosure Obligation, the Care Obligation, and the Conflict of Interest Obligations. These obligations, taken together, are meant to provide assurances to retail customers that broker-dealers provide a certain quality of recommendations that are consistent with the customers' best interest and to enhance retail customer protection. The best interest obligation, including the specific component obligations, may not be reduced or narrowed through contract with a retail customer.

As discussed in Section IV.2, explicit contracts may, in some cases, be inefficient means of ameliorating agency costs. In such cases, legal and regulatory obligations can provide alternative and more efficient tools to ameliorate these costs. For example, FINRA rules require broker-dealers making recommendations to: (i) Have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors, and (ii) based on a particular customer's investment profile, have a reasonable basis to believe that the recommendation is suitable for that customer. Moreover, under FINRA rules, a broker-dealer or associated person who has actual or *de facto* control over a customer's account must have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, is not excessive and unsuitable for the customer when taken together in light of the customer's investment profile.

In the absence of these rules, these requirements are all provisions that could, at least theoretically, be included in broker-dealer account agreements with retail customers. Including these provisions would be meant to provide assurance to the retail customer that a broker-dealer provides a certain quality of recommendations. But inclusion of such provisions would likely have limited effectiveness because the retail customer would have little, if any, ability to confirm the broker-dealer's compliance with the provisions. If these provisions regarding the quality of advice were left open to contract, it is equally likely that the broker-dealer (as the more informed party) would be able to offer less optimal terms regarding the quality of advice to be provided to the retail customer.

Proposed Regulation Best Interest, through the Disclosure, the Care, and the Conflict of Interest Obligations, would incorporate and go beyond current broker-dealer obligations under federal securities laws and SRO rules in ways that would ameliorate the agency conflict between broker-dealers and retail customers and would create a number of potentially significant benefits for retail customers.

As discussed in more detail below, the Disclosure Obligation would foster retail customer awareness and understanding of certain specified information regarding the retail customer's relationship with the broker-dealer as well as material conflicts of interest associated with broker-dealer recommendations. As a result, this obligation would reduce the informational gap between a broker-dealer making a recommendation and a retail customer receiving that recommendation, which, in turn, may cause the retail customer to act differently with regard to the recommendation. For example, the retail customer may reject a broker-dealer recommendation that she would otherwise not reject absent the new information made available by the Disclosure Obligation. Anticipating a potential change in the behavior of the retail customer with respect to acting on recommendations as a result of the Disclosure Obligation, a broker-dealer may adjust its own behavior by providing recommendations that are less likely to be rejected by the retail customer. By virtue of being tailored to the retail customer's anticipated behavior, these recommendations are more likely to be in the retail customer's best interest, and therefore of higher quality relative to the recommendations that the broker-dealer would supply absent this obligation. Thus, the Disclosure Obligation would enhance the quality of recommendations that broker-dealers provide to retail customers. Furthermore, to the extent that uncertainty about a broker-dealer's conflicts of interest associated with a recommendation complicates a retail customer's evaluation of the recommendation, the Disclosure Obligation would reduce that uncertainty and, therefore, would help retail customers better evaluate broker-dealer recommendations.

Similarly, the Care Obligation would allow broker-dealers to provide recommendations at a level of quality that better matches the expectations of its retail customers, and, therefore, would enhance the quality of recommendations that broker-dealers provide to retail customers.

Finally, the Conflict of Interest Obligations would require broker-dealers to establish, maintain, and enforce policies and procedures that are reasonably designed to identify and disclose or eliminate material conflicts of interest and establish, maintain, and enforce policies and procedures that are reasonably designed to identify and eliminate, or disclose and mitigate, material conflicts of interest arising from financial incentives associated with their recommendations. Such policies and procedures would benefit retail customers because they would be designed to reduce conflicts of interest that may motivate the behavior of associated persons of broker-dealers and thereby enhance the quality of the recommendations that they provide to their retail customers. Furthermore, these obligations work in conjunction with the Disclosure Obligation by including requirements designed to reduce the uncertainty with respect to whether a broker-dealer recommendation is subject to conflicts of interest. In particular, the Conflict of Interest Obligations would benefit retail customers by helping them better evaluate the recommendations received from broker-dealers.

a. Disclosure Obligation

Proposed Regulation Best Interest would establish the Disclosure Obligation, which would foster a retail customer's awareness and understanding of specified information regarding the relationship with the broker-dealer as well as material conflicts of interest associated with broker-dealer recommendations. To meet the Disclosure Obligation, the Commission would consider the following to be examples of material facts relating to the scope and terms of the relationship with the retail customer that a broker-dealer would be required to disclose in writing: (1) That it is acting in a broker-dealer capacity with respect to the recommendation; (2) fees and charges that apply to the retail customer's transactions, holdings, and accounts; and (3) type and scope of services provided by the broker-dealer. Additionally, a broker-dealer would be required to disclose in writing all material conflicts of interest that are associated with the recommendation.

Currently, broker-dealers are not subject to an explicit and broad disclosure obligation under the Exchange Act. However, broker-dealers may provide information about their services and accounts, which may include disclosure about a broker-dealer's capacity, fees, and conflicts on their firm websites and in their account opening agreements. In addition, as noted above, broker-dealers are currently subject to specific disclosure obligations when making recommendations. Broker-dealers generally may be liable under federal securities laws' antifraud provisions if they do not give "honest and complete information" or disclose any material adverse facts or material conflict of interest, including economic self-interest. Many of these existing disclosure obligations depend on the facts and circumstances around recommendations, and different broker-dealers may comply with them differently. In addition, these disclosure obligations may not always produce information that is sufficiently relevant to a recommendation to assist a retail customer in meaningfully evaluating the recommendation. For instance, retail customers may not be aware of or understand the broker-dealer's conflicts of interest.[458]

The disclosure obligations for broker-dealers under Regulation Best Interest are more express and more comprehensive compared to existing disclosure requirements and liabilities. Namely, a broker-dealer that makes recommendations to a retail customer would be required to provide the retail customer with sufficiently specific facts about any material conflicts of interest such that the retail customer would be able to understand the conflict and make an informed decision about the broker-dealer recommendations. The Commission has provided preliminary guidance above on aspects of disclosure by a broker-dealer to a retail customer; this disclosure would help the retail customer understand specified information regarding the relationship with the broker-dealer, including the broker-dealer's material conflicts of interest.

In the case of retail customers who have both brokerage and advisory accounts with the same financial professional, such as dual-registrants, it may not always be clear whether the financial professional is acting in a capacity of broker-dealer or investment adviser when providing advice.[459] This information may be useful to the retail customer when evaluating the advice received. For instance, the cost to the retail customer of acting on such advice may depend on whether the advice is tied to the retail customer's brokerage or advisory account.

By articulating an explicit disclosure requirement under the Exchange Act as part of the best interest obligation, the Disclosure Obligation would facilitate improved disclosure practices among broker-dealers. In addition, the Disclosure Obligation would facilitate retail customer awareness and understanding of certain key facts concerning their relationship with a broker-dealer, as well as conflicts of interest, and would provide retail customers with sufficiently specific facts to help them evaluate a broker-dealer recommendation. As a result, the Disclosure Obligation ameliorates the agency conflict between retail customers and broker-dealers, and therefore provides a potentially important benefit to investors in the form of reduced agency conflict between retail customers and broker-dealers.

The magnitude of the benefit from the reduced agency conflict would depend on a number of determinants, such as how retail customers perceive the risk and return of their portfolio, how they would act on a recommendation given the new information made available by the Disclosure Obligation, and, finally, how the risk and return of their portfolio would change as a result of acting on a recommendation. Given the number and complexity of assumptions, the Commission lacks the data that would allow it to narrow the scope of the assumptions regarding these determinants and estimate the magnitude of the benefit.

b. Exercise Reasonable Diligence, Care, Skill, and Prudence

As noted above, the Care Obligation of the proposed rule would go beyond the existing broker-dealer obligations under FINRA's suitability rule by requiring that broker-dealers act in the best interest of their retail customers, without placing the financial or other interest of the broker-dealer or associated person making the recommendation ahead of the interest of the retail customer. Furthermore, the Care Obligation does not include an

[458] *See supra* discussion in Section II.D.

[459] *See supra* discussion in Section II.C.4.

element of control, unlike the quantitative suitability prong of FINRA's suitability rule.

The new requirements of the Care Obligation of proposed Regulation Best Interest may restrict broker-dealers from making certain recommendations. For instance, broker-dealers would not be able to make recommendations to retail customers that comply with FINRA's suitability rule if they do not also comply with all the requirements of the Care Obligation. While the impact of the Care Obligation restrictions on broker-dealer recommendations to retail customers would depend largely, as noted earlier, on the facts and circumstances related to each recommendation and the investment profile of the retail customer receiving that recommendation, the fact that the Care Obligation incorporates and goes beyond existing broker-dealer suitability obligations may yield certain benefits for retail customers. For instance, to the extent that currently broker-dealers comply at all times with FINRA's suitability requirements but do not always account for the retail customer's best interest, as proposed here, when choosing between securities with similar payoffs but different cost structures, the Care Obligation would encourage broker-dealers to recommend a security that would be more appropriately suited to achieve the retail customer's objectives. Thus, by promoting recommendations that are better aligned with the objectives of the retail customer, the Care Obligation of proposed Regulation Best Interest would provide an important benefit to retail customers, ameliorating the agency conflict between broker-dealers and retail customers and, in turn, improving the quality of recommendations that broker-dealers provide to retail customers.

The Commission is unable to quantify the magnitude of these benefits to retail customers for a number of reasons. First, broker-dealer recommendations would depend largely on the facts and circumstances related to each recommendation and the investment profile of the retail customer receiving that recommendation. Second, broker-dealers currently do not have an explicit obligation to act in their customers' best interest when making recommendations. Finally, the magnitude of these benefits to retail customers would depend on how retail customers generally perceive the risk and return of their portfolio, the likelihood of acting on a recommendation that complies with the best interest obligation, and, ultimately, how the risk and return of their portfolio change as a result of how they act on the recommendation. Any estimate of the magnitude of such benefits would depend on assumptions about the facts and circumstances surrounding a recommendation, the investment profile of the retail customer, how retail customers perceive the risk and return of their portfolio, the determinants of the likelihood of acting on a recommendation that complies with the best interest obligation, and, finally, how the risk and return of their portfolio change as a result of how they act on the recommendation. Because the Commission lacks the data that would help narrow the scope of these assumptions, the resulting range of potential estimates would be wide, and, therefore, would not be informative about the magnitude of these benefits to retail customers.

Another way in which the proposed rules would incorporate and go beyond existing standards is by requiring a broker-dealer to 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, regardless of whether the broker-dealer has actual or *de facto* control over a retail customer account. This represents a heightened standard relative to obligations under federal securities laws and under FINRA's concept of quantitative suitability in two ways. First, this proposed requirement applies a best interest standard to a series of recommendations, rather than requiring broker-dealers to merely have a reasonable basis for believing that a series of recommendations are not excessive or unsuitable. Second, by removing the control element, the proposed requirement would expand the scope of retail customers that could benefit from existing suitability requirements to those retail customers who, while retaining control over their own accounts, nevertheless accept a series of broker-dealer recommendations.

The Commission is unable to quantify the magnitude of the benefits that retail customers could receive as a result of the new obligations for broker-dealers that provide a series of recommendations to retail customers for largely the same reasons that make the quantification of the other Care Obligation benefits, as discussed above, difficult.[460]

c. Obligation To Establish, Maintain, and Enforce Written Policies and Procedures Reasonably Designed To Identify and at a Minimum Disclose, or Eliminate, All Material Conflicts of Interest Associated With a Recommendation

Regulation Best Interest would include two requirements relating to the treatment of conflicts. The first requirement under the Conflict of Interest Obligations would require a broker-dealer[461] to establish, maintain, and enforce written policies and procedures reasonably designed to identify and at a minimum disclose, or

[460] The DOL RIA estimates that due to one source of adviser conflicts, namely that conflict related to underperformance associated with front-end load mutual funds, retirement investors will underperform no-load mutual funds by approximately 0.50% to 1.00%, on average, which translates to aggregate losses of between $95 billion to $189 billion over 10 years. *See* The Department of Labor, Regulating Advice Markets: Regulatory Impact Analysis for Final Rule and Exemptions (Apr. 2016), *available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf.* The Department of Labor further estimates that its Fiduciary Rule and the BIC Exemption will reduce those losses attributed to underperformance of front-end load mutual funds by $33 billion to $36 billion over 10 years. *But see* Letter from Craig Lewis (Aug. 31, 2017) (offering a critique of the DOL RIA). Generally, although the DOL RIA provides potential estimates of investor harm and gains to investors as a result of that agency's rule, the Commission has not incorporated those estimates into its own economic analysis because of the differences in scope of the intended effects of Regulation Best Interest. Moreover, because of the range of investor risk profiles and the diversity of products offered by broker-dealers outside of the retirement account context, the Commission is unable to apply the DOL's analytical framework—which focuses primarily on the differences between load and no-load mutual funds as well as analyses that compare broker-dealer advised investments to unadvised direct investments—to its own analysis. With respect to the analysis of costs and benefits associated with proposed Regulation Best Interest, the relevant metric is the differences between broker-dealer advised accounts subject to the current legal framework and broker-dealer advised accounts subject to the proposed rule overlaid on the existing legal framework. *See also* Council of Economic Advisers, The Effects of Conflicted Investment Advice on Retirement Savings, 2015, *available at https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf*, (using the same approach as the DOL RIA, estimates annual losses to retirement investors from conflicted advice at $17 billion per year). *See also* Economic Policy Letter, *supra* note 27. The Consumer Federation of American estimated annual losses from conflicted investment advice between $20 billion and $40 billion per year, while PIABA estimated annual losses at approximately $21 billion per year. *See* CFA 2017 Letter; PIABA Letter.

[461] The proposed Conflict of Interest Obligations apply solely to the broker or dealer entity, and not to the natural persons who are associated persons of a broker or dealer. For purposes of discussing the Conflict of Interest Obligations, the term ''broker-dealer'' refers only to the broker-dealer entity, and not to such individuals. However, the policies and procedures a broker-dealer establishes, maintains, and enforces, pursuant to the proposed Conflict of Interest Obligation, would apply to a broker-dealer's registered representative's conflicts of interest.

eliminate, all material conflicts of interest that are associated with a recommendation. Conflicts of interest may arise for a number of reasons. For example, a broker-dealer may be in a position to recommend: Proprietary products, products of affiliates, or a limited range of products; one share class versus another share class of a mutual fund; securities underwritten by the firm or a broker-dealer affiliate; the roll over or transfer of assets from one type of account to another (such as recommendations to rollover or transfer assets in an ERISA account to an IRA, when the recommendation involves a securities transaction); and allocation of investment opportunities among retail customers. This Conflict of Interest Obligation may benefit retail customers to the extent that a broker-dealer establishes, maintains and enforces policies and procedures to disclose, or eliminate, a material conflict of interest that may have a negative impact on its recommendations to retail customers.

As noted in our earlier discussion of the Disclosure Obligation, a broker-dealer that determines to address a conflict of interest identified through policies and procedures by disclosing it should provide the retail customer, in writing, with sufficiently specific facts so that the customer is able to understand the material conflicts of interest and is able to make an informed decision about the broker-dealer recommendations.

The benefits to retail customers of this disclosed information have been discussed earlier under the Disclosure Obligation. These benefits are difficult to quantify for the same reasons that the benefits of the overall Disclosure Obligation in Section IV.D.1.a. are difficult to quantify.

As noted earlier, as an alternative to addressing a conflict of interest identified through policies and procedures by disclosing it, a broker-dealer may choose, instead, to satisfy this Conflict of Interest Obligation by eliminating it altogether. If a broker-dealer addresses the material conflict of interest by eliminating it, a retail customer benefits from receiving a recommendation that is free of that particular conflict of interest.

Generally, we preliminarily believe that having express Conflict of Interest Obligations would result in broker-dealers establishing policies and procedures focusing specifically on identifying and evaluating conflicts and determining whether each of the identified conflicts is material and should be disclosed or eliminated. We also preliminarily believe that broker-dealers may be more inclined to evaluate and address material conflicts of interest and eliminate more egregious conflicts of interest to the extent that disclosure of the conflict would result in reputation risk. Further, having a clearly defined obligation that would require, among other things, that a broker-dealer establish written policies and procedures reasonably designed to identify and disclose, or eliminate, all material conflicts of interest associated with a recommendation may result in increased retail customer confidence in the recommendation received. Finally, the Conflict of Interest Obligation may improve retail customer welfare, to the extent that the obligation permits retail customers to understand better which recommendations, within a broader set of suitable recommendations, are or are not conflicted and the extent and nature of any such conflicts, while maintaining retail customer access to a broad variety of recommendations.

d. Obligation To Establish, Maintain, and Enforce Written Policies and Procedures Reasonably Designed To Identify and Disclose and Mitigate, or Eliminate, Material Conflicts of Interest Arising From Financial Incentives Associated With a Recommendation

The Conflict of Interest Obligations of proposed Regulation Best Interest include the additional requirement that a broker or dealer, establish, maintain, and enforce written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with a recommendation.

This Conflict of Interest Obligation would apply to material conflicts of interest that arise from financial incentives. As discussed in more detail above, we interpret a material conflict of interest as a conflict of interest that a reasonable person would expect might incline a broker-dealer—consciously or unconsciously—to make a recommendation that is not disinterested. Material conflicts of interest that arise from financial incentives include, but are not limited to, conflicts arising from compensation practices such as how a broker-dealer compensates its employees, and how a broker-dealer is compensated by third-parties for whom it may act as a distributor or service provider.

As noted in our earlier discussion of the Disclosure Obligation, a broker-dealer that determines to address a conflict of interest arising from financial incentives identified through policies and procedures by disclosing and mitigating it should provide the retail customer, in writing, with sufficiently specific facts so that the retail customer is able to understand the material conflicts of interest and is able to make an informed decision about the broker-dealer's recommendations. The benefits to retail customers of this disclosed information have been discussed earlier under the Disclosure Obligation.

As noted earlier, as an alternative to addressing conflicts of interest through disclosure and mitigation of a material conflict of interest arising from financial incentives, a broker-dealer may choose, instead, to satisfy this Conflict of Interest Obligation by eliminating the conflict altogether. If a broker-dealer establishes policies and procedures to address a conflict of interest through eliminating a material conflict of interest arising from financial incentives associated with a recommendation, a retail customer benefits from receiving a recommendation that is free of that particular conflict of interest. In other words, if a retail customer receives a broker-dealer recommendation and written disclosure about certain material conflicts of interest arising from financial incentives associated with the recommendation, the retail customer can expect that the conflicts of interest arising from financial incentives and that are omitted from such disclosure are either not material or eliminated. This may benefit retail customers to the extent that the absence of certain conflicts of interest arising from financial incentives associated with a recommendation may increase retail customers' trust in the advice they obtain and in financial markets.[462] Moreover, in those circumstances where a broker-dealer chooses to address a conflict of interest through elimination because disclosure and mitigation of those conflicts of interest may be too challenging, the broker-dealer would simplify the evaluation of the recommendation by the retail customer.

However, unlike other material conflicts of interest, under proposed Regulation Best Interest, developing policies and procedures to address material conflicts of interest arising from financial incentives through disclosure alone would not be sufficient. The requirement to establish, maintain, and enforce policies and procedures to mitigate conflicts of interest related to financial incentives is a significant expansion of current broker-dealer requirements to address conflicts. As discussed in Section II.D.3.b., the Commission has provided preliminary guidance on reasonably designed policies and procedures for identifying and disclosing and

[462] *See supra* Section IV.B.1.

mitigating, or eliminating, material conflicts of interest arising from financial incentives that allow broker-dealers the flexibility to comply with the Conflict of Interest Obligations based on each firm's circumstances. This approach allows broker-dealers the flexibility to establish policies and procedures reasonably designed to identify and disclose and mitigate, potential conflicts of interest arising from financial incentives and to develop supervisory systems that would help them maintain and enforce their policies and procedures in a manner that reflects their business practices and that focuses on areas of their business practices where heightened concern may be warranted.

The Commission is unable to quantify the size of these benefits for several reasons. First, Regulation Best Interest would provide broker-dealers flexibility in choosing whether to address a conflict of interest arising from financial incentives through disclosure and mitigation, or elimination and flexibility in choosing among methods of mitigation. Second, the size of these benefits would depend on how retail customers generally perceive the risk and return of their portfolio, the likelihood of acting on a recommendation that complies with the best interest obligation, and, ultimately, how the risk and return of their portfolio change as a result of how they act on the recommendations. Any estimate of the size of such benefits would depend on assumptions about how broker-dealers choose to comply with this requirement of the Conflict of Interest Obligations, how retail customers perceive the risk and return of their portfolio, the determinants of the likelihood of acting on a recommendation that complies with the best interest obligation, and, finally, how the risk and return of their portfolio change as a result of how they act on the recommendation. Since the Commission lacks the data that would help narrow the scope of these assumptions, the resulting range of potential estimates would be wide, and, therefore, not informative about the magnitude of these benefits.

2. Costs

In this section, we discuss the costs of a best interest standard of conduct, generally, and the costs associated with the components of Regulation Best Interest, specifically.

As discussed in more detail below, proposed Regulation Best Interest would entail direct costs for broker-dealers and indirect costs for retail customers and other parties with a stake in the market for investment advice (*e.g.,* product sponsors). The magnitude of the costs will depend on several factors: (1) How broker-dealers would choose to comply with the best interest obligation, (2) whether broker-dealers would pass on some of the costs of complying with the best interest obligation to the retail customers, and (3) the extent to which broker-dealers are currently acting in a retail customer's best interest when providing advice, and complying with the existing disclosure requirements and liabilities. Regulation Best Interest would impose a best interest obligation on broker-dealers that would incorporate and go beyond existing suitability obligations under the federal securities laws and SRO rules. The overall cost of proposed Regulation Best Interest would depend on the costs that each of its component obligations, namely the Disclosure, the Care, and the Conflict of Interest Obligations, would impose on broker-dealers, retail customers, and other parties such as product sponsors with a stake in the market for financial advice.

For instance, with respect to the Disclosure Obligation, the disclosure requirements would incorporate and go beyond existing disclosure obligations and liabilities, and, as a result, may impose direct costs on broker-dealers.

With respect to the Care Obligation, the requirement to have a reasonable basis to believe that a recommendation is in the best interest of a particular retail customer based on that retail customer's investment profile and the risks and rewards associated with the recommendation may impose a cost on the broker-dealers that determine that they no longer wish to make certain recommendations to brokerage customers, and, as a result, forgo some of the revenue stream associated with such recommendations. Other requirements of this obligation may impose operational and legal costs on broker-dealers.

Finally, with respect to Conflict of Interest Obligations, the requirement to establish, maintain, and enforce written policies and procedures to eliminate material conflicts of interest as an alternative to disclosing such conflicts may impose potential costs on broker-dealers to the extent that they determine to satisfy this requirement by no longer offering certain recommendations or services, and, therefore, forgo some of the revenue stream associated with such recommendations or services. The requirement to establish, maintain, and enforce written policies and procedures to mitigate or eliminate certain material conflicts of interest arising from financial incentives may alter the incentives of registered representatives to expend effort in providing quality advice, and, therefore, may impose a cost on retail customers due to the potential decline in the quality of recommendations. The same requirement may limit retail customer choice, and therefore impose costs on retail customers, because broker-dealers, for compliance or business reasons, may determine to avoid recommending certain products to retail brokerage customers, despite the fact that these products may be beneficial to certain retail customers in certain circumstances.

The Commission acknowledges that, taken together, the proposed rules may generate tension between broker-dealers' regulatory requirements and their incentives to provide high quality recommendations to retail customers, including by recommending costly or complex products. Retail customers may have diverse and complex investment needs and goals and may benefit from tailored trading strategies and financial products that may entail higher costs (*e.g.,* due to the effort that broker-dealers may have to expend to understand the product and which products would best fit the needs of their retail customers). While this proposal is designed to incorporate and go beyond the existing broker-dealer regulatory regime and ameliorate certain conflicts of interest between retail customers and financial firms, it is not intended to restrict broker-dealers from recommending higher cost products or services to retail customers when appropriate to meet a retail customer's needs or goals, so long as these recommendations meet proposed Regulation Best Interest.[463]

a. Standard of Conduct Defined as Best Interest

As noted above, the proposed rule would establish a best interest standard of conduct for broker-dealers when making recommendations to retail customers. Below, we discuss the operational and programmatic costs anticipated as a result of the proposed rule.

(1) Operational Costs

Broker-dealers typically provide training to their employees with respect

[463] The DOL RIA estimates that the aggregate costs associated with the implementation and compliance with the DOL Fiduciary Rule and the BIC Exemption would be between $10 billion and $31.5 billion over 10 years, with an expected cost of $16.1 billion. *But see* Letter from Craig Lewis (Aug. 31, 2017) (offering a critique of the DOL RIA). As noted above, because of the differences in the scope of Regulation Best Interest, the Commission is not incorporating these estimates into its own analysis.

to relevant legal and regulatory requirements.[464] Firms generally prefer face-to-face training where possible, but large firms tend to use computer-based training to reach their dispersed employees.[465] The proposed rule would create a best interest standard of conduct for broker-dealers. While incorporating the existing standards of conduct for broker-dealers established by the federal securities laws and SRO rules, this rule would enhance existing standards. Consequently, complying with the best interest standard may require additional training for broker-dealer employees. The cost of this training may depend on whether a broker-dealer and its associated persons are already behaving in a way that is consistent with the best interest standard, and whether broker-dealer employees are trained to behave in this manner. In particular, broker-dealers that currently are not behaving consistent with the best interest standard and that are not training their employees to behave in this manner may incur higher training costs. For example, firms already provide training with respect to FINRA suitability rules. As a result, we believe that the costs associated with providing training with respect to the Care Obligation of the proposed rule would be incremental for broker-dealers that are behaving consistent with the best interest standard, but potentially substantial for those broker-dealers that are not. Similarly, broker-dealers currently provide training on material conflicts of interest.[466] However, the Conflict of Interest Obligations of the proposed rule would be different from the existing requirements or liabilities to disclose, and as a result, we believe that the costs associated with providing training with respect to the Conflict of Interest Obligations of the proposed rule could be potentially significant.

In addition to the potential costs described above, certain factors might mitigate the potential costs of proposed Regulation Best Interest. As discussed earlier in Section IV.C, in addition to obligations imposed by the existing standard of conduct, broker-dealers that are servicing retirement accounts would also be subject to obligations imposed by the DOL Fiduciary Rule and the BIC Exemption.[467] Regulation Best Interest would apply consistent regulation to recommendations involving retail customers' retirement and non-retirement accounts. To the extent that there might be a discrepancy between broker-dealer obligations that apply to retirement accounts and those that apply to non-retirement accounts, the proposed rule, through its consistent approach to regulating recommendations involving retail customers' retirement and non-retirement accounts, may reduce any costs associated with such discrepancy. Similarly, to the extent that broker-dealers that do not necessarily service retirement accounts might be subject to and comply with similar overlapping regulations that impose costs on broker-dealers (*e.g.,* state laws that impose fiduciary obligations),[468] proposed Regulation Best Interest may reduce any such costs.

While all broker-dealers would have to comply with Regulation Best Interest, broker-dealers that service retirement accounts would also have to comply with the DOL Fiduciary Rule and the BIC Exemption. Since the best interest obligation of the proposed rule does not incorporate all the requirements that the DOL Fiduciary Rule and the BIC Exemption, broker-dealers that service retirement accounts may incur additional costs as a result of overlapping but not identical regulations. For example, broker-dealers that implement the BIC Exemption would be subject to the disclosure regime imposed by the proposed rule, as well as the disclosure requirements mandated by the BIC Exemption.[469] Similarly, broker-dealers that are not necessarily servicing retirement accounts but could be subject to overlapping but not identical regulation may incur additional costs of complying with such regulation. However, since Regulation Best Interest would not change how broker-dealers would comply with the DOL Fiduciary Rule and the BIC Exemption or other current overlapping regulations, broker-dealers may incur the costs of complying with such regulations even absent an explicit best interest obligation.

(2) Programmatic Costs

The proposed rule may impose programmatic costs on broker-dealers by limiting their ability to make certain recommendations or deterring them from making certain recommendations. To the extent that broker-dealers are currently able to generate revenues from securities recommendations that are consistent with FINRA's suitability rule but not consistent with this proposed best interest obligation, those revenues would be eliminated under the proposed rule. Specifically, if a broker-dealer determines to no longer recommend a product because that product is inferior to another product with similar payoffs but lower cost, the revenue loss would consist of the difference between the cost of the former product and the cost of the latter product. While the FINRA suitability standard does not explicitly prohibit a broker-dealer from putting its interest ahead of the customer's, FINRA interpretations suggest that a broker-dealer may not put its interest ahead of the customer's.[470] The Commission is unable to quantify the magnitude of this potential revenue loss because of the difficulty in identifying systematically recommendations that are consistent with FINRA's suitability rule but not with the proposed rule. The reason why such identification is difficult is because a broker-dealer recommendation depends largely, as noted earlier, on the facts and circumstances related to that recommendation and the investment profile of the retail customer receiving that recommendation. Any estimate of the magnitude of the potential revenue loss would depend on assumptions about a recommendation's potential facts and circumstances and the investment profile of the retail customer receiving the recommendation. Since the Commission lacks the data that would help narrow the scope of these assumptions, the resulting range of potential estimates would be wide, and, therefore, not informative about the magnitude of the potential revenue loss.

Broker-dealers may also face increased costs due to enhanced legal exposure as a result of a potential increase in retail customer arbitrations.[471] Such costs may also be incurred to the extent broker-dealers believe that such an increase may occur and therefore choose to expend

[464] *See* FINRA, ''Report on Conflicts of Interest,'' Oct. 2013.

[465] *Id.* at 15.

[466] *Id.* at 15.

[467] As discussed above, the DOL Fiduciary Rule was vacated by the United States Court of Appeals for the Fifth Circuit on March 15, 2018. *See supra* note 51.

[468] *See supra* note 442.

[469] The disclosure requirements for the BIC Exemption are discussed in the baseline. *See* Section IV.C.2, and *supra* note 52.

[470] *See* Rule 2111, FAQ—Q7.1, *available at http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq.*

[471] Moreover, we note that the proposed rule creates an enhanced standard of conduct for broker-dealers under the Exchange Act. One key difference and enhancement resulting from the obligations imposed by Regulation Best Interest as compared to a broker-dealer's existing obligations under the antifraud provisions of the federal securities laws, is that the antifraud provisions require an element of fraud or deceit, which would not be required under Regulation Best Interest. More specifically, the Care Obligation could not be satisfied by disclosure. To the extent that broker-dealers believe that they may face enhanced legal exposure, they may choose to incur costs in anticipation of any enforcement action.

resources to prepare for additional arbitration claims. Most, if not all, brokerage agreements contain clauses that require retail customers to arbitrate disputes with a broker-dealer through FINRA's Office of Dispute Resolution.[472] In the event that a brokerage agreement contains no such arbitration clause, Rule 12201 of FINRA's Code of Arbitration Procedure for Customer Disputes (the ''FINRA Code'') allows a customer to compel a broker-dealer or person associated with a broker-dealer to arbitrate a dispute.[473] The FINRA Code does not require a customer to allege a cause of action when pursuing arbitration against a broker-dealer; rather, a customer need only specify ''relevant facts and remedies requested.'' [474] Nevertheless, it is unclear whether or to what extent the adoption of Regulation Best Interest would affect the number of retail customer arbitrations, since many retail customer arbitrations are already predicated on facts alleging that a broker-dealer breached a fiduciary duty or breached its suitability obligations.[475]

b. Disclosure Obligation

Proposed Regulation Best Interest would impose a number of obligations on broker-dealers, including the Disclosure Obligation.

As noted earlier, the Disclosure Obligation would incorporate and go beyond the existing disclosure obligations and liabilities by establishing an explicit disclosure requirement for broker-dealers under the Exchange Act, by facilitating a more uniform level of disclosure of the material scope and terms of the relationship between broker-dealer and retail customer as well as broker-dealer material conflicts of interest across broker-dealers and by providing retail customers with sufficiently specific facts concerning their relationship with broker-dealers.

As discussed earlier, certain requirements of the Disclosure Obligation could be satisfied in part by complying with the requirements of the concurrent proposed Relationship Summary and Regulatory Status Disclosure. For instance, with respect to the requirement to disclose a broker-dealer's capacity, a standalone broker-dealer would be able to satisfy fully the requirement by delivering the Relationship Summary to the retail customer and by maintaining a reasonable basis to believe that a retail customer had been delivered the Relationship Summary prior to or at the time when a recommendation was made, and by complying with the Regulatory Status Disclosure. In contrast, a dual-registrant would only be able to satisfy partially the requirement to disclose a broker-dealer's capacity by complying with the Relationship Summary rule and the Regulatory Status Disclosure. Given that a dual-registrant may act in broker-dealer capacity or investment adviser capacity when providing advice to a retail customer, a dual-registrant would have to comply with the Disclosure Obligation expressly.[476] Thus, while standalone broker-dealers that comply with the Relationship Summary rule would not incur additional costs to comply with this requirement of the Disclosure Obligation, dual-registrants would. However, dual-registrants would be given flexibility with respect to the form, timing, or method of satisfying this requirement of the Disclosure Obligation when they make recommendations in the capacity of broker-dealer.

With respect to the requirement to disclose a broker-dealer's fees, the Disclosure Obligation may enhance the informativeness of the broker-dealer disclosure to retail customers over the existing disclosure practices. Currently, disclosure practices with respect to a broker-dealer's fees may not be sufficiently informative to remove a retail customer's uncertainty about the fees that it would have to pay by acting on a broker-dealer recommendation.[477] The proposed Relationship Summary rule would require broker-dealers to disclose general information about the types of fees that retail customers would be expected to pay when receiving services from broker-dealers, but not quantitative fee information. However, in addition to the Relationship Summary, the Disclosure Obligation would foster more detailed fee disclosure, and would require broker-dealers to provide, at the minimum, additional detail about the fees described in the Relationship Summary, such as fee amounts, percentages and ranges. Thus, even for those broker-dealers that comply with the Relationship Summary, the Disclosure Obligation with respect to disclosure of a broker-dealer's fees would impose additional costs on broker-dealers. However, broker-dealers would have flexibility as to the form and timing of how to satisfy this requirement of the Disclosure Obligation.

Finally, broker-dealers would be able to satisfy the requirement to disclose all material conflicts of interest by complying with the requirements of the Conflict of Interest Obligations. Thus, for broker-dealers that comply with the Conflict of Interest Obligations, the Disclosure Obligation with respect to disclosure of material conflicts of interest would impose no additional costs on broker-dealers. The Conflict of Interest Obligations would impose costs on broker-dealers, and those costs are discussed in more detail below.

As noted above, proposed Regulation Best Interest would give broker-dealers flexibility with respect to the form, timing, or method of complying with the disclosure requirements. While this flexibility would help broker-dealers tailor their form, timing, or method of complying with the disclosure requirements to their business practices, it may also impose a cost on broker-dealers because, in the absence of a mandated form, timing, or method of disclosure, broker-dealers would have to expend resources to develop standardized methods of disclosure that could be easily understood by their retail customers.

Finally, as discussed above, the requirement to create certain written records of information collected from and provided to a retail customer of the Disclosure Obligation may impose additional costs on broker-dealers. This new record-making requirement would amend Exchange Act Rule 17a–3 by adding new paragraph (a)(25) that would require that a broker-dealer create a record of all information collected from and provided to the retail customer pursuant to Regulation Best Interest. In addition, the Commission is proposing to amend Exchange Act Rule 17a–4(e)(5) to require broker-dealers to retain the records required pursuant to Rule 17a–3(a)(25) for at least six years.

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472 *See* SEC Investor Bulletin: Broker-Dealer/Customer Arbitration (Dec. 20, 2016), *available at https://www.sec.gov/oiea/investor-alerts-bulletins/ib_arbitration.html* (''[A]ccount opening agreements will almost always contain a provision binding the parties to arbitration in the event of a dispute . . . [FINRA] handles almost all securities industry arbitrations and mediations.'').

473 See FINRA Rule 12200 (''Parties must arbitrate a dispute under the Code if: Arbitration under the Code is either: (1) Required by a written agreement; or (2) Requested by the customer. . . .''). See also SEC Investor Bulletin: Broker-Dealer/Customer Arbitration (Dec. 20, 2016), available at *https://www.sec.gov/oiea/investor-alerts-bulletins/ib_arbitration.html.*

474 *See* FINRA Rule 12302.

475 *See* FINRA Dispute Resolution Statistics, Top 15 Controversy Types in Customer Arbitrations, *available at https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics#top15controversycustomers* (of cases served from January through October 2017, 1,529 cases alleged a breach of fiduciary duty; during that same period, 1,279 cases alleged a breach of suitability obligations).

476 Financial professionals who are dually-registered, but who are affiliated with different standalone broker-dealers and investment advisers would have the same obligation.

477 *See, e.g., supra* note 192.

The Commission is unable to fully quantify the costs of the Disclosure Obligation due to a number of factors. First, the Commission lacks data on the extent to which current disclosure practices are different from the disclosure requirements of the Disclosure Obligation. Second, given that the proposed rule would give broker-dealers flexibility in complying with the requirements of the Disclosure Obligation, there could be multiple ways in which broker-dealers may satisfy these requirements. Finally, the portion of compliance costs that broker-dealers may pass on to retail customers may depend on the costs that a retail customer would incur to switch from one broker-dealer to another or from a broker-dealer to an investment adviser

While a range of estimates for the costs of the Disclosure Obligation may be difficult to obtain due to the potentially wide range of assumptions about these factors, preliminary estimates for the portion of these costs borne by broker-dealers may be obtained under specific assumptions. As discussed further in Section V.D, the Commission preliminarily believes that the preparation and delivery of standardized language, fee schedules, and standardized conflict disclosures that broker-dealers are expected to provide to retail customers to comply with the Disclosure Obligation would impose an initial aggregate burden of 5,808,703 hours and an additional initial aggregate cost of $40.79 million as well as an ongoing aggregate burden of 1,965,564 hours on broker-dealers.[478] Thus, the Disclosure Obligation of proposed Regulation Best Interest would impose an initial aggregate cost of at least $1,391.07 million and an ongoing aggregate annual cost of at least $460.81 million on broker-dealers.[479] In addition, the Commission believes that the record-making obligation of proposed Rule 17a–3(a)(25) and the recordkeeping obligation of the proposed amendment to Rule 17a–4(e)(5) associated with the Disclosure Obligation and the obligations of proposed Regulation Best Interest would impose an initial aggregate burden of 19,678,777 hours and an additional initial aggregate cost of $378,544 as well as an ongoing aggregate annualized burden of 3,173,334 hours on broker-dealers.[480] Thus, the record-making obligation of proposed Regulation Best Interest would impose an initial aggregate cost of at least $4,516.56 million and an ongoing aggregate annual cost of at least $1,141.81 million on broker-dealers.[481]

c. Obligation To Exercise Reasonable Diligence, Care, Skill, and Prudence in Making a Recommendation

The Care Obligation of the proposed rule, as described above, would incorporate and go beyond a broker-dealer's existing obligations in two ways. First, the proposed obligation would draw on broker-dealers' existing well-established obligations for ''customer-specific suitability,'' but would go beyond those obligations by requiring that the broker-dealer have a reasonable basis to believe that the recommendation is in the best interest of the retail customer based on the retail customer's investment profile. Second, the proposed rule would require a broker-dealer to have a reasonable basis to believe that a series of transactions is not excessive and is in the retail customer's best interest, regardless of whether the broker-dealer has actual or *de facto* control over a retail account. As described in Section IV.B above,

[478] The estimate of the initial aggregate burden is based on the following calculation: 3,600 hours + 8,020 hours + 41,100 hours + 1,904,000 hours + 4,010 hours + 20,550 hours + 1,904,000 hours + 4,010 hours + 15,413 hours + 1,904,000 hours = 5,808,703 hours. As discussed in more detail in Section V.D., 3,600, 8,020, and 41,100 hours are preliminary estimates of the initial aggregate burden for the preparation of disclosure of capacity, type and scope, for dual registrants, small and large broker-dealers, respectively. 1,904,000 hours is the preliminary estimate of the initial aggregate burden for the delivery of the disclosure of capacity, type and scope to retail customers. 4,010 and 20,550 hours are preliminary estimates of the initial aggregate burden for the preparation of disclosure of fees for small and large broker-dealers, respectively. 1,904,000 hours is the preliminary estimate of the initial aggregate burden for the delivery of the disclosure of fees to retail customers. 4,010 and 15,413 hours are preliminary estimates of the initial aggregate burden for the preparation of disclosure of material conflicts of interest for small and large broker-dealers, respectively. 1,904,000 hours is the preliminary estimate of the initial aggregate burden for the delivery of the disclosure of material conflicts of interest to retail customers. The estimate of the initial aggregate cost is based on the following calculation: $1.70 million + $3.79 million + $14.55 million + $1.89 million + $9.70 million + $1.89 million + $7.27 million = $40.79 million. As discussed in more detail in Section V.D., $1.70 million, $3.79 million, and $14.55 million are preliminary estimates of the initial aggregate cost for the preparation of disclosure of capacity, type and scope, for dual registrants, small and large broker-dealers, respectively. $1.89 million and $9.70 million are preliminary estimates of the initial aggregate cost for the preparation of disclosure of fees for small and large broker-dealers, respectively. $1.89 million and $7.27 million are preliminary estimates of the initial aggregate cost for the preparation of disclosure of material conflicts of interest for small and large broker-dealers, respectively. The estimate of the ongoing aggregate burden is based on the following calculation: 2,520 hours + 3,208 hours + 41,100 hours + 380,800 hours + 1,604 hours + 8,220 hours + 761,600 hours + 802 hours + 4,110 hours + 761,600 hours = 1,965,564 hours. As discussed in more detail in Section V.D., 2,520, 3,208, and 41,100 hours are preliminary estimates of the ongoing aggregate burden for the preparation of disclosure of capacity, type and scope, for dual registrants, small and large broker-dealers, respectively. 380,800 hours is the preliminary estimate of the ongoing aggregate burden for the delivery of the disclosure of capacity, type and scope to retail customers. 1,604 and 8,220 hours are preliminary estimates of the ongoing aggregate burden for the preparation of disclosure of fees for small and large broker-dealers, respectively. 761,600 hours is the preliminary estimate of the ongoing aggregate burden for the delivery of the disclosure of fees to retail customers. 802 and 4,110 hours are preliminary estimates of the ongoing aggregate burden for the preparation of disclosure of material conflicts of interest for small and large broker-dealers, respectively. 761,600 hours is the preliminary estimate of the ongoing aggregate burden for the delivery of the disclosure of material conflicts of interest to retail customers.

[479] These estimates are calculated as follows: (96,703 hours of in-house legal counsel) × ($409.37/hour for in-house counsel) + (5,712,000 hours for delivery for each customer account) × ($229.46/hour for registered representative) + (86,428 hours for outside legal counsel) × ($472/hour for outside legal counsel) = $1,391.07 million, and (35,555 hours of in-house legal counsel) × ($409.37/hour for in-house counsel) + (1,904,000 hours for delivery for each customer account) × ($229.46/hour for registered representative) + (26,009 hours for in-house compliance counsel) × ($359.81/hour for outside legal counsel) = $460.81 million. The hourly wages for in-house legal and compliance counsel and registered representatives are obtained from SIFMA. The hourly rates for outside legal counsel are discussed in Section V.D.

[480] These estimates are based on the Commission's preliminary estimates, discussed in Section V.D, with respect to the initial and ongoing aggregate costs and burdens imposed on broker-dealers by the record-making obligation of proposed Rule 17a–3(a)(25) and the recordkeeping obligation of the proposed amendment to Rule 17a–4(e)(5) associated with all component obligations of the proposed Regulation Best Interest. The estimate of the initial aggregate burden is based on the following calculation: 4,110 hours + 3,808,000 hours + 15,866,667 hours = 19,678,777 hours, where, as discussed in more detail in Section V.D, 4,110 hours is the preliminary estimate of amending the account disclosure agreement by large broker-dealers, 3,808,000 hours is the preliminary estimate of the burden associated with filling out the information disclosed pursuant to Regulation Best Interest in the account disclosure agreement, and 15,866,667 hours is the preliminary estimate of the burden to broker-dealers for adding new documents or modifying existing documents to the broker-dealer's existing retention system. $378,544 is the preliminary estimate of amending the account disclosure agreement by small broker-dealers pursuant to the record-making obligation of proposed Rule 17a–3(a)(25). 3,173,334 hours is the preliminary estimate of the ongoing aggregate annual burden to broker-dealers of complying with the recordkeeping obligation of the proposed amendment to Rule 17a–4(e)(5).

[481] These estimates are calculated as follows: (2,055 hours of in-house legal counsel) × ($409.37/hour for in-house counsel) + (19,674,667 hours for entering and adding new or modifying existing documents in each customer account) × ($229.46/hour for registered representative) + (2,055 hours for in-house compliance counsel) × ($359.81/hour for in-house compliance counsel) + (802 hours for outside legal counsel) × ($472/hour for outside legal counsel) = $4,516.56 million, and (3,173,334 hours for record keeping) × ($229.46/hour for registered representative) = $1,141.81 million. The hourly wages for in-house legal and compliance counsel and registered representatives are obtained from SIFMA. The hourly rates for outside legal counsel are discussed in Section V.D.

existing suitability rules require that a broker-dealer or associated person have a reasonable basis to believe that a recommendation or investment strategy is ''suitable'' for the retail customer.[482] Suitability depends, among other things, on information obtained by the broker-dealer or associated person about the retail customer's investment profile (*e.g.,* age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, need for liquidity, and risk tolerance).[483] In particular, pursuant to the requirements of FINRA's suitability rule, currently, broker-dealers are expected to make efforts to ascertain the potential risk and rewards associated with a recommendation, given a customer's investment profile, and to determine whether the recommendation could be in suitable for at least some retail customers. Furthermore, broker-dealers are expected to evaluate the information in a retail customer's investment profile and other relevant information when determining whether a recommendation is suitable or whether a series of recommendations is suitable and not excessive.

Under FINRA's suitability rule and other applicable legal standards, broker-dealers are also expected to make an effort to ascertain relevant information about a retail customer's investment profile prior to making a recommendation on an ''as needed'' basis. In general, the reasonableness of a broker-dealer's effort to collect information regarding a customer's investment profile information depends on the facts and circumstances of a given situation.[484] We understand that currently broker-dealers collect information relevant to a customer's investment profile at the inception of the relationship with the retail customer through the use of a questionnaire, such as in an account opening agreement, and during the relationship on an ''as needed'' basis.

The requirements of the Care Obligation of proposed Regulation Best Interest mirror closely but are not identical to the current broker-dealer practices pursuant to the requirements of FINRA's suitability rule and other applicable legal standards. The first important difference is the requirement that broker-dealers have a reasonable basis to believe that a recommendation is in the best interest of a retail customer and that a series of recommendations is not excessive and in the best interest of the retail customer. The suitability standard does not have an explicit best interest requirement and therefore broker-dealers may be able to make recommendations today that, while suitable, may not meet the Care Obligation proposed as part of Regulation Best Interest. As noted above, to the extent that current broker-dealer practices pursuant to the requirements of FINRA's suitability rule do not reflect the proposed best interest standard of conduct, the Care Obligation would impose a cost on broker-dealers. The other important difference is the removal of the element of control from the requirement to have a reasonable basis to believe that a series of recommendations is not excessive and in the best interest of the retail customer. As noted above, unlike the quantitative suitability requirement of FINRA's suitability rule, this requirement of the Care Obligation applies irrespective of whether a broker-dealer has actual or *de facto* control over the account of the retail customer. To the extent that the removal of the element of control may cause a potential increase in retail customer arbitrations, the Care Obligation would impose a cost on broker-dealers due to enhanced legal exposure.[485]

As noted earlier, the proposed rule would also amend Exchange Act Rule 17a–4(e)(5) to require broker-dealers to retain any customer information that the customer would provide to the broker-dealer pursuant to Regulation Best Interest, as well as copies of any conflict disclosures provided to the customer by the broker-dealer pursuant to Regulation Best Interest, in addition to the existing requirement to retain information obtained pursuant to Exchange Act Rule 17a–3(a)(17). Furthermore, broker-dealers would be required to retain all of the retail customer investment profile information that they would obtain as well as copies of conflict disclosures they would provide for six years. Currently, under Rule 17a–3(a)(17), broker-dealers that make recommendations for accounts with a natural person as customer or owner are required to create, and periodically update, specified customer account information. However, the information collection requirements of Rule 17a–3(a)(17) do not cover all aspects of ''customer investment profile'' that broker-dealers may attempt to obtain to make a customer-specific suitability determination under FINRA's suitability rule. To the extent that a retail customer would provide a broker-dealer with information about the customer's investment profile pursuant to either FINRA's suitability rule or Regulation Best Interest, the proposed rule would require that broker-dealers retain that information for six years. However, since the Care Obligation of proposed Regulation Best Interest has no record-making requirement with respect to information that broker-dealers obtain from retail customers, the Commission believes that the costs to the broker-dealers of the retention requirement to be small.

The Care Obligation may also impose costs on retail customers, to the extent that broker-dealers pass on costs to their retail customers. The Commission is unable to fully quantify the size of these costs due to a number of factors. First, while the FINRA suitability standard does not explicitly prohibit a broker-dealer from putting its interest ahead of the customer's, FINRA's interpretation suggests that a broker-dealer may not put its interest ahead of the customer's.[486] Second, it is unclear whether or to what extent the adoption of Regulation Best Interest would affect the number of retail customer arbitrations, since many retail customer arbitrations are already predicated on facts alleging that a broker-dealer breached a fiduciary duty or breached its suitability obligations.[487] Finally, the portion of the costs that broker-dealers may pass on to retail customers may depend on the costs that a retail customer would incur to switch from one broker-dealer to another or from a broker-dealer to an investment adviser. While a range of estimates for the costs of the Care Obligation may be difficult to obtain due to the potentially wide range of assumptions about these factors, preliminary estimates for the portion of these costs borne by broker-dealers may be obtained under specific assumptions. For instance, the Commission believes that, with respect to the Care Obligation, the record-making obligation of proposed Rule 17a–3(a)(25) and the recordkeeping obligation of the proposed amendment to Rule 17a–4(e)(5) would involve creating new documents or modifying existing documents to reflect standardized questionnaires seeking customer investment profile information. The costs associated with the record-making and recordkeeping obligations are discussed in Section IV.D.2.b above, and in more detail in Section V.D below.

[482] *See supra* note 431.

[483] *See supra* note 241.

[484] *See* FINRA Regulatory Notice 12–25 at Q16.

[485] *See infra* note 511.

[486] *See* Rule 2111, FAQ—Q7.1, *available at http://www.finra.org/industry/faq-finra-rule-2111-suitability-faq.*

[487] *See supra* note 475 and accompanying text.

d. Obligation To Establish, Maintain, and Enforce Written Policies and Procedures Reasonably Designed To Identify and at a Minimum Disclose, or Eliminate, All Material Conflicts of Interest Associated With a Recommendation

As noted above, proposed Regulation Best Interest would require broker-dealers to comply with two Conflict of Interest Obligations. The first of these obligations would require a broker-dealer to establish, maintain, and enforce written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with a recommendation.[488] These conflicts may arise for a number of reasons. For example, a broker-dealer may be in a position to recommend: Proprietary products, products of affiliates, or limited range of products; one share class versus another share class of a mutual fund; securities underwritten by the firm or a broker-dealer affiliate; the rollover or transfer of assets from one type of account to another (such as recommendations to roll over or transfer assets in an ERISA account to an IRA, when the recommendation involves a securities transaction); and allocation of investment opportunities among retail customers. Broker-dealers would also need to consider whether these conflicts arise from financial incentives and therefore are subject to the additional Conflict of Interest Obligation to establish, maintain, and enforce written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with a recommendation that is discussed in more detail below.

Before determining whether to satisfy this Conflict of Interest Obligation by disclosing, or eliminating, all material conflicts of interest associated with a recommendation, broker-dealers would have to first identify such material conflicts. To this end, the obligation would require that broker-dealers establish written policies and procedures reasonably designed to identify material conflicts of interest. In particular, these policies and procedures would be expected to identify a conflict in a manner that is relevant to a broker-dealer's business practice, identify which conflicts arises from financial incentives, provide a structure for identifying new conflicts as broker-dealers' business practices evolve, and provide a structure for an ongoing review for the identification of conflicts relevant to current business practices.

Once the broker-dealer identifies a material conflict of interest associated with a recommendation, the obligation requires that broker-dealers establish written policies and procedures reasonably designed to at a minimum disclose, or eliminate, the identified material conflict of interest. In addition, reasonably designed policies and procedures would likely include a discussion regarding the delivery of a Relationship Summary, Regulatory Status Disclosure, or other standardized documentation developed to disclose material conflicts of interest to the retail customer. The Commission preliminarily believes that such policies and procedures would provide a structure for effectively addressing new or existing material conflicts of interest that are relevant to a recommendation.

If a broker-dealer determines to satisfy the obligation through disclosure, the broker-dealer would be expected to provide the retail customer, in writing, with sufficiently specific facts so that the customer is able to understand the conflicts of interest a broker-dealer has and can make an informed decision about a recommended transaction or strategy. As noted above, proposed Regulation Best Interest would provide broker-dealers with flexibility in determining the most appropriate way to meet their disclosure obligation in a manner consistent with their business practices.

If a broker-dealer determines to satisfy the obligation by eliminating an identified material conflict of interest, the broker-dealer would be expected to, for instance, remove any incentives associated with recommending a particular product or service, not offer products that come with associated incentives, or negate the effect of the conflict. The effects of this obligation on broker-dealers and their retail customers are discussed in more detail below.

In addition to the requirement that broker-dealers establish written policies and procedures to identify and at a minimum disclose, or eliminate, material conflicts of interest, the obligation would also require that broker-dealers maintain and enforce such policies and procedures. Toward that end, broker-dealers would be expected to develop risk-based compliance and supervisory systems that promote compliance with proposed Regulation Best Interest consistent with their business practices and in a manner that focuses on areas of those business practices that pose risks of violating the Conflict of Interest Obligations. Broker-dealers are currently subject to supervisory obligations under Section 15(b)(4)(E) of the Exchange Act and SRO rules, including the establishment of policies and procedures reasonably designed to prevent and detect violations of, and to achieve compliance with, the federal securities laws and regulations, as well as applicable SRO rules.[489] Consequently, in order to comply with the requirement to maintain and enforce the policies and procedures pursuant to the requirement to establish such policies and procedures of the Conflict of Interest Obligation, broker-dealers could adjust their current systems of supervision and compliance, as opposed to creating new systems.

The requirement to establish, maintain, and enforce written policies and procedures to identify and at a minimum disclose, or eliminate, material conflicts of interest would impose initial and ongoing costs and burdens on broker-dealers. As discussed in more detail in Section V.D., the Commission preliminarily believes that broker-dealers would update their policies and procedures to comply with this requirement and would incur an initial aggregate burden of 131,320 hours and an additional initial aggregate cost of approximately $24.84 million, as well as an ongoing aggregate annualized burden of 28,670 hours, and an ongoing aggregate annualized cost of approximately $3.08 million.[490] Furthermore, the Commission preliminarily believes that in order to identify conflicts of interest and determine whether the conflicts are material, broker-dealers would incur an

[488] As discussed in Section I.B above, one key difference and enhancement resulting from the obligations imposed by Regulation Best Interest, as compared to a broker-dealer's existing suitability obligations under the antifraud provisions of the federal securities laws, is that the antifraud provisions require an element of fraud or deceit, which would not be required under Regulation Best Interest. More specifically, the Care Obligation could not be satisfied by disclosure.

[489] *See* FINRA Rule 3110 (Supervision) (requiring firms to establish and maintain systems to supervise the activities of their associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules).

[490] These estimates are based on the following calculations: 123,300 hours + 8,020 hours = 131,320 hours; $9.7 million + $15.1 million = $24.8 million; and 24,660 hours + 4,010 hours = 28,670 hours. As discussed in more detail in Section V.D, 123,300 hours and 8,020 hours are preliminary estimates for the initial aggregate burdens for large and small broker-dealers, respectively, $9.7 million and $15.1 million are preliminary estimates for the initial aggregate costs for large and small broker-dealers, respectively, and 24,660 hours and 4,010 hours are preliminary estimates for the ongoing aggregate burdens for large and small broker-dealers, respectively.

initial aggregate burden of 28,570 hours and an additional initial aggregate cost of approximately $15.43 million as well as an ongoing aggregate annualized burden of 28,570 hours.[491] Finally, the Commission preliminarily believes that in order to maintain and enforce written policies pursuant to the obligation to identify and at the minimum disclose, or eliminate, material conflicts of interest broker-dealers would incur an initial aggregate burden of 446,499 hours and an additional initial aggregate cost of approximately $61.71 million as well as an ongoing aggregate annualized burden of 435,071 hours.[492] Thus, the Conflict of Interest Obligation of proposed Regulation Best Interest would impose an initial aggregate cost of at least $273.01 million and an ongoing aggregate annual cost of at least $120.92 million on broker-dealers.[493]

[491] The estimate of the initial aggregate burden is based on the following calculations: 14,285 hours + 14,285 hours = 28,570 hours, where, as discussed in more detail in Section V.D, 14,285 hours and 14,285 hours are preliminary estimates for the initial aggregate burdens for identifying conflicts of interest and determining whether the conflicts are material for all broker-dealers, respectively.

[492] The estimate of the initial aggregate burden is based on the following calculations: 11,428 hours + 435,071 hours = 446,499 hours, where, as discussed in more detail in Section V.D, 11,428 hours and 435,071 hours are preliminary estimates for the initial aggregate burdens of approving training modules and training of registered representatives for all broker-dealers, respectively.

[493] These estimates are calculated as follows: (106,209 hours of in-house legal counsel) × ($409.37/hour for in-house counsel) + (435,071 hours for training) × ($229.46/hour for registered representative) + (27,692.5 hours for in-house compliance counsel) × ($359.81/hour for in-house compliance counsel) + (7,142.5 hours for determining if identified conflicts of interest are material) × ($270.40/hour for senior business analyst) + (30,274 hours for review of policies and procedures) × ($522.49/hour for compliance manager) + (52,630 hours for outside legal counsel) × ($472/hour for outside legal counsel) + (57,140 hours for modifying existing technology) × ($270/hour for outside senior programmer) + (228,560 hours for updating training module) × ($270/hour for systems analyst or programmer) = $273.01 million, and (8,220 hours of in-house legal counsel) × ($409.37/hour for in-house counsel) + (435,071 hours for training) × ($229.46/hour for registered representative) + (26,515 hours for in-house compliance counsel) × ($359.81/hour for in-house compliance counsel) + (25,505 hours for identifying conflicts of interest) × ($226.23/hour for business-line personnel) + (30,274 hours for review of policies and procedures) × ($522.49/hour for compliance manager) + (4,010 hours for outside legal counsel) × ($472/hour for outside legal counsel) + (4,010 hours for outside compliance services) × ($298/hour for outside compliance services) = $120.92 million. The hourly wages for in-house legal and compliance counsel, registered representatives, senior business analyst, compliance manager, and business-line personnel are obtained from SIFMA. The hourly rates for outside legal counsel, outside senior programmer, systems analyst or programmer and outside compliance services are discussed in Section V.D.

(1) Eliminate Material Conflicts of Interest Associated With a Recommendation

Broker-dealers may offer a wide variety of dealer services and products to retail customers. Under the Exchange Act, a ''dealer'' is defined as ''any person engaged in the business of buying and selling securities (not including security-based swaps, other than security-based swaps with or for persons that are not eligible contract participants) for such person's own account through a broker or otherwise.''[494] Dealer activity may include, but is not limited to, selling securities (such as bonds) out of inventory; buying securities from customers; selling proprietary products (*e.g.,* products such as affiliated mutual funds, structured products, private equity and other alternative investments); selling initial and follow-on public offerings; selling other underwritten offerings; acting as principal in Individual Retirement Accounts; acting as a market maker or specialist on an organized exchange or trading system; acting as a *de facto* market maker or liquidity provider; and otherwise holding oneself out as buying or selling securities on a continuous basis at a regular place of business.

In all of these instances broker-dealers transact with their customers as principals. As discussed above, when a broker-dealer makes a recommendation to a retail customer that involves products or services associated with its dealer activities, the recommendation would be subject to a conflict of interest. The Conflict of Interest Obligations would require that broker-dealers establish, maintain, and enforce written policies and procedures reasonably designed to identify and disclose (and mitigate when financial incentives are involved), or eliminate such conflicts of interest that are material.

If a broker-dealer determines to comply with the Conflict of Interest Obligations by eliminating material conflicts of interest associated with recommendations on products or services on which the broker-dealer acts as a dealer, the broker-dealer would be expected to, for instance, remove any incentives associated with recommending such products or services, not offer products that come with associated incentives, or negate the effect of the conflict. For instance, the broker-dealer may choose to no longer recommend such products or services or continue to make such recommendations but effectuate the transactions in a way that does not involve a principal trade.

[494] Section 3(a)(5)(A) of the Exchange Act.

Eliminating this type of conflict of interest may have an impact on broker-dealers' revenue and may reduce the set of securities transactions recommended by a broker-dealer; or it may alter the specific securities transactions that a broker-dealer recommends or the manner and cost and quality of execution (*e.g.,* because a broker-dealer places an order with a third-party market maker rather than its own proprietary trading desk). Further, dealers act as important financial market intermediaries by providing liquidity to retail customers and helping to maintain continuous and smooth price transitions for securities. If broker-dealers determine to eliminate material conflicts of interest, the resulting change to how this critical role is performed could impact market liquidity.

The costs of complying with the Conflict of Interest Obligation by eliminating material conflicts of interest related to financial incentives that arise from broker activity are discussed in a subsequent section below.

(2) At a Minimum Disclose Material Conflicts of Interest Associated With a Recommendation

A broker-dealer would have to establish, maintain, and enforce written policies and procedures that are reasonably designed to at a minimum disclose those material conflicts of interest that the broker-dealer does not determine to eliminate.

As described in Section IV.B above, when making a recommendation, broker-dealers are subject to a number of disclosure requirements under current Commission antifraud obligations, Exchange Act rules, and FINRA rules. Also, as described in Sections I.A and IV.B above, when engaging in transactions directly with customers on a principal basis, a broker-dealer violates Exchange Act Rule 10b–5 when it knowingly or recklessly sells a security to a customer at a price not reasonably related to the prevailing market price and charges excessive markups, without disclosing the fact to the customer. Exchange Act Rule 10b–10 also requires a broker-dealer effecting transactions in securities to provide written notice to the customer of certain information specific to the transaction at or before the completion of the transaction, including the capacity in which the broker-dealer is acting (*i.e.,* agent or principal).[495]

[495] *See* Rule 10b–10. Rule 10b–10 requires a broker-dealer effecting customer transactions in

Continued

The Commission believes that policies and procedures would likely include instructions for a broker-dealer to determine whether a material conflict of interest, once identified, would need to be disclosed.

As noted above, Regulation Best Interest would not prescribe the process by which broker-dealers should disclose all material conflicts of interest to their retail customers. Instead, the proposed rule would give broker-dealers flexibility in identifying the most efficient and effective way of complying with the disclosure obligation that is consistent with a broker-dealer's business practice. Furthermore, although the obligation to disclose material conflicts of interest may impose costs on broker-dealers, the Commission preliminarily believes that permitting disclosure instead of outright elimination of material conflicts may reduce the costs the overall best interest obligation could impose on retail customers. This is because the disclosure alternative may preserve access to any recommendations that retail customers currently might find beneficial, even taking into account the existence of material conflicts.

Broker-dealers that currently employ minimal disclosure practices that comply with the current disclosure requirements under federal securities laws and applicable SRO rules about material conflicts of interest with respect to their recommendations may incur higher costs of complying with this enhanced disclosure obligation.

The Commission is unable to fully quantify these costs due to a number of factors. First, the Commission lacks data that quantifies how different current disclosure practices are compared to where they should be to comply with the disclosure obligation with respect to conflicts of interest. Second, given that the proposed rule allows broker-dealers flexibility in complying with the disclosure obligation, there could be multiple ways in which broker-dealers could satisfy this obligation. While a range of estimates for the costs of disclosure obligation with respect to conflicts of interest may be difficult to obtain due to the potentially wide range of assumptions about these factors, preliminary estimates for the portion of these costs borne by broker-dealers may be obtained under specific assumptions. These latter costs are discussed in Section IV.D.2.b above and in more detail in Section V.D. below.

e. Obligation To Establish, Maintain, and Enforce Written Policies and Procedures Reasonably Designed To Identify and Disclose and Mitigate, or Eliminate, Material Conflicts of Interest Arising From Financial Incentives Associated With a Recommendation

Proposed Regulation Best Interest also includes the additional requirement that a broker, dealer, or associated person establish, maintain, and enforce written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with a recommendation.

As noted above, we would interpret a material conflict of interest arising from financial incentives to include the structure of fees and other charges for the services provided and products sold; employee compensation or employment incentives (*e.g.,* quotas, bonuses, sales contests, special awards, differential or variable compensation, incentives tied to appraisals or performance reviews); and compensation practices involving third-parties, such as sales compensation and compensation for services provided to third-parties or to retail customers on behalf of third parties (*e.g.,* sub-accounting or administrative services provided to a mutual fund). In particular, financial incentives that create material conflicts of interest from financial incentives may include, for example, differential or variable compensation received by the broker-dealer itself (but not an affiliate), whether paid by the retail customer or a third-party; receipt of fees, commissions or other charges on sales of proprietary products, and transactions on a principal basis.

Broker-dealers may consider establishing policies and procedures like the following to fulfill the Conflict of Interest Obligation: Policies and procedures outlining how the firm identifies its material conflicts (and material conflicts arising from financial incentives), including such material conflicts of natural persons associated with the broker-dealer, clearly identifying all such material conflicts of interest and specifying how the broker-dealer intends to address each conflict; robust compliance review and monitoring systems; processes to escalate identified instances of noncompliance to appropriate personnel for remediation; procedures that clearly designate responsibility to business lines personnel for supervision of functions and persons, including determination of compensation; processes for escalating conflicts of interest; processes for a periodic review and testing of the adequacy and effectiveness of policies and procedures; and training on the policies and procedures. Furthermore, as noted above, such policies and procedures would be expected to provide a structure for effectively addressing new or existing material conflicts of interest that arise from financial incentives associated with a recommendation, including whether to disclose and mitigate or eliminate such a conflict. Finally, in order to enforce such policies and procedures, and consistent with the discussion above, broker-dealers may determine that it is necessary to modify their current supervisory systems or develop new ones.

The requirement to establish, maintain, and enforce written polices pursuant to the requirement to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives of the Conflict of Interest Obligations would impose costs on broker-dealers. These costs are discussed in Section IV.D.2.d above and in more detail in Section V.D below.

(1) Eliminate Material Conflicts Arising From Financial Incentives Associated With a Recommendation

For some broker-dealers, compensation arrangements with product-sponsoring third parties may be an important source of revenue. For instance, as described in Section IV.B, sales of investment company products range on average between 8 percent and 20 percent of broker-dealer revenue, depending on the size of the broker-dealer. Some (but not necessarily all) of these products are subject to compensation arrangements between broker-dealers and third parties that are sponsoring these products. As noted above, when making recommendations to retail customers on products that are subject to compensation arrangements, a broker-dealer has a financial incentive, and therefore a conflict of interest. The Conflict of Interest Obligations would require that the broker-dealer establish, maintain, and enforce written policies that are reasonably designed to identify and disclose and mitigate, or eliminate this type of conflict of interest. If a broker-dealer were to determine to eliminate this conflict, the broker-dealer would have to take actions that would negate the existence of the conflict in the first place. For instance, the broker-dealer could credit retail customers all

securities (other than U.S. savings bonds or municipal securities) to provide written notification to the customer, at or before completion of the transaction, disclosing information specific to the transaction, including whether the broker-dealer is acting as agent or principal and its compensation, as well as any third-party remuneration it has received or will receive. *See also* NASD Rule 2340 (Customer Account Statements) (broker-dealers must provide customer account statements on at least a quarterly basis).

the compensation it receives from product sponsors when recommending their products to retail customers. Alternatively, the broker-dealer could stop providing recommendations to retail customers on products that are subject to compensation arrangements. In both cases, the broker-dealer would forgo all the revenues tied to compensation paid by product sponsors for distributing their products to retail customers.

More generally, broker-dealers that determine to eliminate conflicts of interest arising from financial incentives may lose up to the entire revenue stream associated with recommending products that are subject to compensation arrangements. However, to the extent that eliminating the conflict of interest arising from financial incentives causes broker-dealers to offer only products that are no longer subject to this type of conflict, the revenue stream generated by these products would offset some of the revenue loss associated with products no longer recommended. Furthermore, to the extent that broker-dealers that chose to eliminate this conflict would limit their recommendations on products subject to compensation arrangements, retail customers would no longer have access to the same advice. The Commission preliminarily believes that the cost to broker-dealers of eliminating conflicts of interest arising from financial incentives could be large. As noted earlier, investment company products account currently for a significant portion of broker-dealers' revenues. However, only a portion of such revenues come from recommendations that broker-dealers make on investment company products to retail customers. Since the Commission lacks data at this level of granularity, the Commission is unable to quantify the magnitude of the potential revenue loss from eliminating conflicts of interest associated with financial incentives. Similarly, for reasons that include the aforementioned data limitation and the difficulty in quantifying how retail customers value broker-dealer advice (*e.g.,* as discussed earlier, the value of broker-dealer advice to retail customers would depend on how retail customers generally perceive the risk and return of their portfolio, the likelihood of acting on a recommendation that complies with the best interest obligation, and, ultimately, how the risk and return of their portfolio change as a result of how they act on the recommendation), the Commission is unable to quantify the magnitude of the cost to retail customers of no longer having access to the advice.

In addition to conflicts of interest arising from financial incentives, broker-dealers also may be subject to conflicts of interest associated with internal compensation structures that may give rise to financial incentives to registered representatives. Much as there is an agency relationship between retail customers and broker-dealers, there is an agency relationship between broker-dealers and registered representatives. Broker-dealer and registered representative incentives may not be perfectly aligned. Like any agency relationship, contracts can be structured in such a way as to better align the incentives of the broker-dealer and its registered representatives. For example, broker-dealers may offer registered representatives compensation structures that reward them based on the amount of revenues they bring in from providing services, including advice. Such compensation structures are designed to benefit both the broker-dealers and the registered representatives by motivating greater effort by registered representatives. If a broker-dealer were to eliminate the use of compensation structures that motivate effort by registered representatives, its revenues would likely decline unless offset by replacement revenue streams. At the same time, the agency costs associated with the relationship between a broker-dealer and its registered representatives could increase to the point where such a relationship may not be justified going forward. In particular, a registered representative at a standalone broker-dealer may determine to terminate his or her relationship with the broker-dealer, while a registered representative at a dual-registrant may determine to offer advice only in a capacity of investment adviser. Such dynamics would have a negative impact on the supply of broker-dealer recommendations, which, in turn, would limit retail customer access to broker-dealer advice.

Given these considerations, we preliminarily believe that the costs associated with eliminating material conflicts of interest associated with compensation structures could be large for both broker-dealers and retail customers. However, the Commission is unable to fully quantify the magnitude of such costs due to a number of factors. First, the cost to broker-dealers would depend on determinants such as the extent to which internal compensation structures reward registered representatives for generating revenues and the sensitivity of broker-dealer revenues to elements of the registered representatives' compensation contract that rewards them for generating revenue (*e.g.,* the portion of commission that they can retain). Currently, the Commission has data only on the former determinant—as described in Section IV.C—and lacks data on the second determinant. Second, the cost to retail customers would depend on determinants such as how retail customers perceive the risks and returns of their portfolios, the likelihood of acting on a recommendation that complies with the best interest obligation, and how those risk and returns change as a result of a decline or change in the supply of broker-dealer recommendations. While a range of estimates for these costs may be difficult to obtain due to the potentially wide range of assumptions about these factors, preliminary estimates for the portion of these costs borne by broker-dealers may be obtained under specific assumptions. For instance, the Commission preliminarily believes that reasonably designed policies and procedures should establish a clearly defined process for determining how to address any identified material conflict of interest, including whether and how to eliminate a material conflict of interest arising from financial incentives. The costs associated with establishing, maintaining and enforcing such policies are discussed in Section IV.D.2.d above and in more detail in Section V.D below.

(2) Disclose and Mitigate Material Conflicts of Interest Arising From Financial Incentives Associated With a Recommendation

As noted earlier, when providing recommendations, broker-dealers potentially are liable under the federal securities laws' antifraud provisions if they do not give ''honest and complete information'' or disclose all material adverse facts and material conflicts of interest, including economic self-interest, in connection with a recommendation. The disclosure obligations for broker-dealer material conflicts of interest—including conflicts related to financial incentives—under Regulation Best Interest would go beyond the existing disclosure requirements and liabilities. Namely, a broker-dealer making a recommendation to a retail customer would be expected to provide the retail customer with sufficiently specific facts about any material conflicts of interest arising from financial incentives associated with the recommendation such that the retail customer would be able to understand the conflict and make an informed decision about the recommendation.

A broker-dealer would have to establish, maintain, and enforce written policies and procedures that are reasonably designed to disclose and mitigate those material conflicts of interest arising from financial incentives that the broker-dealer does not determine to eliminate. The Commission expects that such policies and procedures would include instructions for a broker-dealer to determine whether a material conflict of interest, once identified, would need to be disclosed and mitigated.

The requirement to establish, maintain, and enforce written policies and procedures that are reasonably designed to disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives of the Conflict of Interest Obligations would impose costs on broker-dealers. Broker-dealers that currently engage in disclosure practices that are closer to the disclosure obligation of the proposed rule would likely incur lower costs of complying with this obligation. However, as noted above, Regulation Best Interest would provide broker-dealers with flexibility in determining the most appropriate way to meet this disclosure obligation, consistent with each broker-dealer's business practices.

Similar to the discussion above about the disclosure obligation with respect to all conflicts of interest, the Commission is unable to fully quantify the costs associated with this obligation due to two factors. First, the Commission lacks data that quantifies how different current disclosure practices are compared to where they should be to comply with the disclosure obligation with respect to conflicts of interest arising from financial incentives. Second, given that the proposed rule allows broker-dealers flexibility in complying with this disclosure obligation, there could be multiple ways in which broker-dealers could satisfy this obligation. While a range of estimates for the costs of disclosure obligation may be difficult to obtain due to the potentially wide range of assumptions about these factors, preliminary estimates for the portion of these costs borne by broker-dealers may be obtained under specific assumptions. These latter costs are discussed in Section IV.D.2.b above and in more detail in Section V.D below.

In addition to the disclosure obligation, the Conflict of Interest Obligations of Regulation Best Interest would also require that broker-dealers to establish, maintain, and enforce policies and procedures to mitigate conflicts of interest related to financial incentives—including conflicts arising from internal compensation structures and compensation arrangements with product sponsors. The costs that broker-dealers would potentially incur to comply with this new requirement depends on what may constitute reasonable mitigation. The proposed rule does not stipulate specific conflict mitigation measures. Instead, the Commission's proposal would give broker-dealers flexibility to develop and tailor policies and procedures aimed at conflict mitigation measures based on each firm's business practices (such as the size of the firm, retail customer base, the nature and significance of the compensation conflict, and the complexity of the product).

Some conflicts of interest related to financial incentives arise from internal compensation structures. As discussed above, the Commission preliminarily believes that the costs to broker-dealers from eliminating material conflicts of interest associated with compensation structures could be large. As an alternative, broker-dealers could retain the compensation structures to address the incentive conflict between the broker-dealers and registered representatives, while taking actions to mitigate the material conflict of interest that those structures may create between broker-dealers or registered representatives and retail customers.

Certain aspects of the market for brokerage services may serve, on their own, to mitigate, to some extent, conflicts of interest between broker-dealers and retail customers that may arise from compensation structures. Potential legal liability and reputational risk related to unsuitable recommendations can serve as a motivation to ameliorate the conflict between broker-dealer representatives and customers. Concerned about their potential legal liability as well as their reputations, many broker-dealers currently take actions to ameliorate conflicts.[496] For example, some broker-dealers may use ''product agnostic'' compensation structures (also referred to as ''neutral grids'') that reduce a registered representative's incentive to recommend one type of product over another.[497] Broker-dealers can also cap the credit a registered representative receives for selling comparable products, thereby reducing the registered representative's incentive to prefer, for example, one mutual fund or variable annuity over another.[498] Further, broker-dealers can impose compensation adjustments on registered representatives who do not properly manage material conflicts of interest.[499] Another mechanism for mitigating the conflict between registered representatives and customers is for broker-dealers to link surveillance of registered representatives' recommendations, and potential compensation adjustments, to thresholds in a firm's compensation structure to deter recommendations that may be motivated by a desire to receive higher compensation.[500] A number of firms also perform specialized supervision and surveillance of recommendations, which could result in compensation adjustments, as a registered representative approaches the end of the period over which performance is measured for receiving bonuses.[501] Finally, a number of firms perform additional surveillance which could result in compensation adjustments when a registered representative approaches the threshold necessary for admission to a firm recognition club.[502]

As noted above, proposed Regulation Best Interest would give broker-dealers the flexibility to develop and tailor individual conflict mitigating measures based on their business practices. The cost of mitigating material conflicts associated with financial incentives will depend, among other things, upon the extent to which broker-dealers are currently engaging in conflict mitigating activities. As discussed above, FINRA's 2013 study of conflicts states that a number of firms are already engaging to various degrees in some of those activities.[503] For those firms that currently engage to a larger extent in conflict mitigating activities, we would expect that the costs associated with the Conflict of Interest Obligations of the proposed rule to be lower. However, the Commission is currently unable to quantify the magnitude of the costs to broker-dealers for complying with the Conflict of Interest Obligation to mitigate material conflicts of interest related to financial incentives, as applied to internal compensation structures, for a number of reasons.

[496] *See* FINRA Report on Conflicts of Interest (Oct. 2013), at 6, *available at http://www.finra.org/sites/default/files/Industry/p359971.pdf.*

[497] *Id.*

[498] *Id.*

[499] *Id.*

[500] *Id.*

[501] *Id.*

[502] *Id.*

[503] *Id.* The FINRA study notes that its observations are drawn from discussions with large firms. As a result, FINRA notes that the findings of the study will not in all cases be directly applicable to small firms. *See* FINRA Report on Conflicts of Interest at p. 2.

First, the Commission lacks data that quantifies the costs of firms engaging in conflict mitigating activities. Second, given that the proposed rule allows broker-dealers to tailor their conflict mitigating measures to their business practices, there could be multiple ways in which broker-dealers could address the conflict mitigating aspect of the Conflict of Interest Obligation. Finally, any estimate of the magnitude of such costs would depend on assumptions about the extent to which broker-dealers are currently engaging in conflict mitigating activities and how broker-dealers would choose to satisfy the Conflict of Interest Obligation with respect to conflicts of interest arising from internal compensation structures. Because the Commission lacks the data that would help narrow the scope of these assumptions, the resulting range of potential estimates would be wide, and, therefore, may not be informative (in a statistical sense) about the magnitude of the costs associated with mitigating conflicts of interest arising from internal compensation structures.

Conflicts of interest related to financial incentives may also arise from financial arrangements between broker-dealers and product sponsors. Furthermore, as discussed above, the Commission preliminarily believes that the costs to broker-dealers from eliminating material conflicts of interest associated with financial incentives could be large. As an alternative, broker-dealers may determine not to eliminate a conflict and instead to mitigate it. To comply with the Conflict of Interest Obligations of the proposed rule, broker-dealers that offer recommendations to retail customers based on products subject to agreement with product sponsors would have to adopt conflict mitigation measures that would reasonably meet these obligations. As noted earlier, the proposed rule does not explicitly specify mandatory conflict mitigation measures. Instead, the rule would give broker-dealers flexibility to develop and tailor conflict mitigation measures consistent with their business practices.

Some broker-dealers may determine to eliminate the most expensive products. For instance, broker-dealers may perceive that the monitoring costs of ensuring that their registered representatives act in the retail customer's best interest when making recommendations based on the full set of offered products (including the most and least expensive products) may be too large. It is possible that such an approach, which eliminates products based on cost alone, may result in a broker-dealer not making available products that, while being more expensive, may provide better performance than products that are still offered. Thus, conflict mitigating measures that constrain the set of products offered may limit retail customer choice and, therefore, may impose a cost on retail customers. Furthermore, these conflict mitigating measures may impact the way registered representatives get compensated, and, therefore, may alter their incentives to expend effort (*e.g.,* to understand the product and the customer that would best fit the product) in providing recommendations of higher quality. The potential change in the level of effort that registered representatives expend when making recommendations may alter the quality of advice that retail customers receive, which, in turn, may impose a cost on retail customers. Alternatively, some broker-dealers may determine to reduce the set of offered products in each product class by eliminating those products that are the least expensive, or by eliminating both the most and the least expensive. This approach would result in a set of products that would be more homogeneously priced, in order to comply with the mitigation aspect of the Conflict of Interest Obligations. However, like the approach above, this approach may also limit retail customer choice, and, therefore, may impose a cost on retail customers.

More generally, the use of tailored products by broker-dealers to mitigate conflicts of interest arising from financial incentives may introduce additional complexities that could ultimately increase the costs borne by retail customers. Therefore, there may be circumstances where broker-dealers determine that eliminating rather than mitigating conflicts through the use of products would be more advantageous for the retail customer.

The factors that would affect a broker-dealer's choice to either eliminate or mitigate conflicts are likely to vary. One example involving the range of considerations that would need to be taken into account is the use of ''clean'' shares, launched recently by a number of mutual fund families. Clean shares, unlike other types of mutual fund share classes, do not involve typical sales and servicing fees. Instead, broker-dealers would be able to set their own commissions which could be structured to avoid the conflicts posed by existing distribution and servicing fee structures. For instance, broker-dealers could set the commissions for these products according to neutral factors that have been discussed earlier.[504]

While some broker-dealers may determine that clean shares are a potential solution to mitigating conflicts of interest arising from compensation arrangements for mutual funds, because broker-dealers could set the fee schedules according to neutral factors, retail customers purchasing clean shares could face higher costs compared to other share classes depending on the investors' holding period for the shares. For some retail customers with short time horizons, clean shares may be more costly relative to other mutual fund share classes. Moreover, due to the nature of clean shares, retail customers may not receive other benefits associated with some mutual fund share classes, such as rights of accumulation that allow investors to account for the value of previous fund purchases with the value of the current purchases. Investors also may not be able to use letters of intent for further purchases to qualify for breakpoint discounts.

In addition, broker-dealers that use clean shares may incur costs stemming from, among other things, back-office work, training of employees, reprogramming of systems, changes to compliance and desk policies and procedures, and changes to clearing procedures. In addition, while some fund complexes currently offer clean shares, not all of them do. While this trend may change in the future, broker-dealers may not be able to offer products that rely on clean shares in each product class. Further, broker-dealers may choose to incorporate clean shares into compliance systems for other commission-based products.

For broker-dealers that determine to rely on clean shares to mitigate conflicts related to financial incentives, revenues may either increase or decrease depending on the extent that the commissions charged on the clean share products are different than the overall

[504] Mutual fund sponsors may use different combinations of sales and servicing fees to discriminate among investors with different expected holding periods. Investors who redeem impose costs on those who remain in a fund. As a result, long-term investors may be unwilling to invest alongside investors with shorter expected holding periods. Differing sales and servicing fees can induce investors to self-select into different funds based on their expected holding period, thereby solving the long-term investors' problem of investing alongside investors with shorter expected holding periods which may, in turn, induce more investment by long-term investors. *See* Tarun Chordia, ''The structure of mutual fund charges,'' Journal of Financial Economics (1996, vol. 41, pp. 3–39). If broker-dealers meet the conflict mitigation requirement of the proposed rule by relying on a single commission schedule, funds would not have the ability to induce investors to self-select into different funds based on expected holding period.

compensation with other funds. Furthermore, to the extent that clean shares would lead to significant changes in how broker-dealers and their associated persons would get compensated, the incentives of broker-dealers when providing advice may change. In particular, if the new compensation arrangement reduces the incentives of broker-dealers to exert effort in providing quality advice, broker-dealer recommendations could end up being of lower quality.

As noted earlier, in general, complying with the Conflict of Interest Obligations to mitigate certain material conflicts of interest may reduce broker-dealers' incentives to provide recommendations of high quality to their retail customers, and, therefore, may impose a cost on retail customers who seek advice from broker-dealers. Furthermore, certain conflict mitigation measures may be costly to implement. These implementation costs would be borne by broker-dealers, and, to the extent that they can pass on some of the costs to their retail customers, by retail customers as well.

Another way in which a broker-dealer may determine to mitigate a material conflict of interest arising from compensation arrangements with product sponsors is by expanding the set of products that the broker-dealer may recommend to a retail customer to include products that are less prone to this type of conflict of interest. That is, a broker-dealer could recommend several products that satisfy the best interest obligation and achieve the same goal (as perceived by the broker-dealer) but that differ along several dimensions, such as expected performance and the amount of compensation that the broker-dealer receives from product sponsors. Presumably, no choice in this set of suitable recommendations is strictly dominated by any of the other choices, or else some of the recommendations in this set would not be consistent with the best interest obligation. To the extent that the retail customer picks a choice in this set that happens to offer less compensation to the broker-dealer compared to the choice that the broker-dealer would have recommended under the baseline, the broker-dealer may incur some revenue loss.

The discussion above suggests that the requirement to establish, maintain, and enforce written policies and procedures to mitigate material conflicts of interest arising from financial incentives may impose costs on broker-dealers, such as potential revenue loss and costs related to the implementation of conflict mitigating measures. The Commission is unable to quantify the magnitude of these costs for a number of reasons. First, the Commission lacks data on the extent to which current broker-dealer recommendations are subject to conflicts of interest related to financial incentives. Second, given that the proposed rule allows broker-dealers to tailor their conflict mitigating measures to their business practices, there could be multiple ways in which broker-dealers could address the conflict mitigating aspect of the Conflict of Interest Obligation. Finally, any estimate of the magnitude of such costs would depend on assumptions about the extent to which broker-dealers are currently providing retail customers with conflicted recommendations, how broker-dealers would choose to satisfy the conflict mitigating aspect of the obligation, the costs associated with implementing conflict mitigating measures, and, finally, how retail customers would respond to recommendations that reflect a given set of conflict mitigating measures. While a range of estimates for the costs of the mitigation aspect of the Conflict of Interest Obligation may be difficult to obtain due to the potentially wide range of assumptions about these factors, preliminary estimates for the portion of these costs borne by broker-dealers may be obtained under specific assumptions. For instance, the Commission preliminarily believes that reasonably designed policies and procedures should establish a clearly defined process for determining how to address any identified material conflict of interest, including whether and how to disclose and mitigate a material conflict of interest arising from financial incentives. The costs associated with establishing, maintaining, and enforcing such policies are discussed in Section IV.D.2.d.

The discussion above also suggests that the way broker-dealers choose to comply with the requirement to establish, maintain, and enforce written policies and procedures to mitigate material conflicts of interest arising from financial incentives may impose costs on retail customers. If a broker-dealer errs on the side of caution and pursues the most conservative rather than the optimal conflict mitigating measures, retail customers may end up with fewer investment choices,[505] and lower quality advice. For instance, if the main determinant of compensation differential across products is the level of effort it takes a broker-dealer to understand the product and the customer that would best fit the product, conflict mitigating measures that either lead to the elimination of some of these products or that render the compensation to be less sensitive to the effort exerted by broker-dealer may reduce the investment choices available to the retail brokerage customer, and, more generally, may reduce the quality of the recommendations that a retail customer obtains from the broker-dealer. In addition, retail customers may bear some of the costs associated with broker-dealers' implementation of conflict mitigating measures.

The Commission is unable to quantify the magnitude of the costs to retail customers due to having access to potentially fewer investment choices and a potential decline in the quality of recommendations received, because such costs would depend on determinants such as how retail customers generally perceive the risk and return of their portfolio, the likelihood of acting on a recommendation that complies with the best interest obligation, and, ultimately, how the risk and return of their portfolio change as a result of how they act on the recommendation. Since the Commission lacks the data that would help narrow the scope of the assumptions regarding these determinants, the resulting range of potential estimates would be wide, and, therefore, not informative about the magnitude of the costs that the conflict mitigating aspect of the Conflict of Interest Obligation would impose on retail customers.

In addition to the potential costs imposed on broker-dealers and retail customers, the conflict mitigating aspect of the Conflict of Interest Obligations may also impose costs on product sponsors that sell their products through broker-dealers. If product sponsors rely on the broker-dealers' distribution channels to fund their products, and use compensation arrangements that create financial incentives for broker-dealers, the proposed best interest obligation may undermine those incentives and may adversely impact the funding of these products.

Specifically, broker-dealers may determine to mitigate conflicts of interest arising from financial incentives tied to compensation from product sponsors by no longer offering some of those products. These conflict mitigating measures would affect the funding of the products that are being eliminated, and therefore, the proposed rule may impose funding costs on product sponsors. The Commission is unable to quantify the magnitude of these funding costs for several reasons. First, it is difficult to identify the

[505] *See* SIFMA Study.

products that broker-dealers may no longer recommend to retail customers. Second, as noted above, there could be multiple ways in which broker-dealers could satisfy the Conflict of Interest Obligation with respect to conflicts of interest due to compensation arrangements with product sponsors. Finally, any estimate of the magnitude of such funding costs would depend on assumptions about the distribution of products across product sponsors that broker-dealers would no longer recommend to retail customers and how broker-dealers would choose to satisfy the Conflict of Interest Obligation with respect to conflicts of interest due to compensation arrangements with product sponsors. Since the Commission lacks the data that would help narrow the scope of these assumptions, the resulting range of potential estimates would be wide, and, therefore, not informative about the magnitude of the funding costs to product sponsors.

D. Effects on Efficiency, Competition, and Capital Formation

In this section, we discuss the impact that proposed Regulation Best Interest may have on efficiency, competition, and capital formation. As discussed above, the proposed rule entails both benefits and costs. The tradeoff between the benefits and costs, and the resulting effect on the gains from trade to be shared between broker-dealers and retail customers, is essential for evaluating the impact of the proposed rule on efficiency, competition, and capital formation.[506]

Competition. By establishing a best interest standard of conduct that would incorporate and expand the current broker-dealer obligations, Regulation Best Interest would ameliorate the principal-agent conflict between retail customers and broker-dealers. However, the proposed rule would impose costs on broker-dealers, retail customers and other parties with a stake in the market for financial advice, and in particular, product sponsors.

To the extent that retail customers perceive that the amelioration of the principal-agency conflict reinforces retail customers' beliefs that broker-dealers will act in their best interest, retail customers' demand for broker-dealer recommendations may increase. In turn, the potential increase in the demand for broker-dealer recommendations could lead to an increase in the number of broker-dealers in the marketplace, and therefore to an increase in the competition among broker-dealers. An increase in competition could manifest itself in terms of better service, better pricing, or some combination of the two, for retail customers.

However, Regulation Best Interest could also have negative effects on competition. It is possible that in the process of ameliorating the agency conflict between broker-dealer and retail customers, Regulation Best Interest may impose costs on broker-dealers or retail customers that would be large enough to reduce the gains from trade shared by broker-dealers and retail customers. For instance, to the extent that the cost of the rule to broker-dealers would cause some broker-dealers to charge more for providing advice, the proposed rule may have negative competitive effects for retail customers in the form of higher pricing for advice. Similarly, to the extent that the reduction in the gains from trade causes a significant reduction in the supply of broker-dealer advice, the proposed rule may have negative competitive effects for retail customers in the form of higher prices for advice.

The reduction in the gains from trade for broker-dealers may come in the form of lower profits. In some cases, the reduction in profits may be large enough to cause some broker-dealers or their associated persons to no longer offer broker-dealer advice. In particular, the potential reduction in the profits associated with broker-dealer advice may create further incentives for some standalone broker-dealers and their associated persons to join investment advisers and, in the process, persuade their retail customers to become investment advisory clients. Similarly, some dually-registered broker-dealers may decide to only offer advice through the investment advisory side of the business or to persuade their customers to switch to advisory accounts. Regulation Best Interest may also have a differential impact on broker-dealers depending on whether they are standalone or dual-registrants. Unlike standalone broker-dealers, a dual-registrant would be able to offer advice in its capacity as an investment adviser but execute the transaction in its capacity as a broker-dealer. Because such a dual-registrant acted as a broker-dealer solely when providing execution services and not when providing advice, the dual-registrant would not be subject to the requirements of the proposed rule for its advice. Rather, the dual-registrant would be subject to the investment advisers' fiduciary standard of care.[507]

If a dual-registrant would incur a larger cost of complying with the new requirements of the best interest obligation compared to the cost of complying with the requirements of the investment advisers' fiduciary standard of care and the concurrent proposed interpretation for investment advisers with respect to providing advice, the dual-registrant may have an incentive to bypass the requirements of the proposed rule by providing advice in the capacity of investment adviser, while executing transactions in the capacity of broker-dealer. To the extent that dual-registrants would engage in this practice, and to the extent that retail customers would be willing to pay for this type of advice, the magnitude of impacts from Regulation Best Interest would be lower for dual-registrants than for standalone broker-dealers. As a corollary, the proposed rule could give dual-registrants a competitive advantage over standalone broker-dealers.

Beyond having an effect on competition among broker-dealers, it is possible that the proposed rule could affect competition between broker-dealers and investment advisers. Whether the proposed rule will have an effect on competition between broker-dealers and investment advisers will depend on how they market their services for advice and how potential customers choose between the two. For certain retail customers, fee structure or costs may be the primary driver of the choice of whether to obtain advice from a broker-dealer or an investment adviser. For example, a buy-and-hold retail customer or a retail customer who does not trade often may find the one-time commission charge commonly charged by a broker-dealer preferable to the ongoing percent-of-assets under management fee of an investment adviser. Because the proposed rules are not likely to change the way broker-dealers and investment advisers charge for their services, the proposed rules may not substantially alter the way in which retail customers that are sensitive to differences in fee structures and costs choose between the two.[508]

[506] "Gains from trade" is defined as the difference between the highest price a consumer is willing to pay for a product or service and the lowest price at which the producer is willing to supply the product or service. *See* Section IV.B.b.

[507] *See* Fiduciary Duty Interpretive Release.

[508] A customer's relationship with an associated person of a broker-dealer or investment adviser may also influence the proposed rule's effect on how customers choose between the two. For example, customers who have relationships with an associated person outside of their professional relationship (*e.g.,* they are members of the same family, they are friends, they are members of the same or similar organizations) may choose the associated person, at least in part, based on those outside relationships. To the extent customers and

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It may be the case, however, that certain retail customers base their choice between a broker-dealer and an investment adviser, at least in part, on their perception of the standards of conduct each owes to their customers. For example, there may be retail customers who prefer the commission structure of a broker-dealer, but who also prefer the fiduciary standard of conduct applicable to investment advisers. For certain of those retail customers, the preference for a fiduciary standard of care may lead them to choose an investment adviser. Because the proposed rule establishes a best interest standard of conduct that incorporates and goes beyond the current broker-dealer standard of conduct, broker-dealers may be better able to compete with investment advisers for those customers. To the extent that there are customers who prefer the commission structure of a broker-dealer, but who chose to use an investment adviser because of their fiduciary standard of conduct, we expect that the proposed rule will enhance competition between broker-dealers and investment advisers.

The gains from trade that result from broker-dealers complying with Regulation Best Interest may depend also on the type of products being recommended. It may be the case that for certain products that broker-dealers are currently offering, the best interest standard improves the gains from trade to such an extent that retail customer demand for broker-dealers' recommendations with respect to those products increases. Similarly, the best interest standard may also have a positive impact on retail customer demand for broker-dealer recommendations in the case of products that are currently offered only by a limited set of broker-dealers. The overall potential increase in the demand for broker-dealer recommendations would encourage entry in the broker-dealer sector, which would tend to lead to increased competition among broker-dealers. An increase in competition could manifest itself in terms of better service, better pricing, or some combination of the two, for retail customers.

Conversely, it may be the case that for some products the best interest standard reduces the gains from trade to such an extent that broker-dealers determine to no longer make recommendations to retail customers with respect to those products. The potential decline in the number of broker-dealers willing to provide recommendations to their brokerage customers for these products may have negative competitive effects within the markets where these products are traded. For instance, if a significant portion of the trading volume in these products flows from retail customers acting on recommendations from broker-dealers, then the possibility of broker-dealers no longer offering recommendations on these products may adversely impact the pricing and availability of these products.

The potentially negative impact of complying with the best interest obligation of the proposed rule on the pricing of products that may no longer be part of some broker-dealers' product offering would likely be diminished for those products that are available to purchase outside a broker-dealer distribution channel. Products that broker-dealers offer advice on currently also may be offered through other non-broker-dealer channels such as investment advisers and commercial banks. For example, commercial banks can engage in broker-dealer activity, subject to certain conditions, without having to register as broker-dealers.[509] The decline in the supply of these products through broker-dealer recommendations may cause product sponsors to increase the supply of these products through non-broker-dealer entities that offer advice. In turn, this potential increase in supply may offset some of the potential negative effects of the proposed rule on the pricing of these products.

In addition, the possibility that broker-dealers may determine to no longer offer recommendations related to certain products that are subject to compensation arrangements with product sponsors may have a potential competitive impact on product sponsors. To the extent that product sponsors compete over funding for their products based on compensation arrangements with broker-dealers, the mitigation measures that broker-dealers may implement to comply with the best interest obligation, such as the potential elimination of some of these products, may change how product sponsors compete with each other. For instance, product sponsors may, under the proposed rules, choose to compete based on product quality rather than compensation arrangements with the broker-dealers that distribute the products.

Capital Formation and Efficiency. As noted above, to the extent that the proposed rule improves the gains from trade for retail customers, these enhanced gains from trade could, in turn, result in current retail customers being willing to invest more of their savings in securities markets and potential retail customers being willing to invest through broker-dealers for the first time. To the extent that the proposed rule leads to greater investment, it may promote capital formation by supplying more capital to issuers at lower cost.

A portion of the enhanced gains from trade may be attributable to the best interest standard enhancing the quality of recommendations provided by broker-dealers to retail customers relative to the baseline. Recommendations that broker-dealers make to retail customers would be of higher quality if they were to promote investment opportunities that better help customers achieve their investment goals. These recommendations are not only consistent with the proposed best interest standard but may also reflect the higher effort that broker-dealers expend to understand the universe of investment opportunities that would fit best with the retail customers' investment profiles. Higher quality recommendations may also be a manifestation of the proposed rules' impact on competition between broker-dealers that may choose to compete more intensively on the quality of recommendations. At the same time, however, the incentives of broker-dealers to expend effort when providing quality recommendations would depend on how broker-dealers choose to respond to this rule and, if they continue to make recommendations to brokerage customers, how they choose to mitigate certain material conflicts of interest. To the extent that the tradeoff between enhancing the quality of advice and mitigating material conflicts of interest results in facilitating higher quality broker-dealer recommendations to retail customers, Regulation Best Interest could improve the efficiency of retail customers' portfolios that benefit from broker-dealer advice.

Among investment opportunities that better help customers achieve their savings goals, there would be some that would finance valuable projects in the corporate sector of the economy (as opposed to the financial sector, *e.g.,* expanding the production of a product that is in high demand). To the extent that a retail customer acting on a high-

associated persons have relationships outside of their professional relationships and to the extent those outside relationships are determinative of the customer's choice between a broker-dealer and an investment adviser, the proposed rule would not substantially alter the way customers choose between the two.

[509] *See* Exchange Act Sections 3(a)(4)(B) and 3(a)(5)(B) and rules thereunder (providing banks exceptions from ''broker'' and ''dealer'' status for specified securities activities).

quality broker-dealer recommendation efficiently allocates new capital to an investment opportunity that funds valuable corporate sector projects, Regulation Best Interest, as proposed, could improve the efficiency with which capital in the economy is allocated to the corporate sector.

As noted above, the proposed rule also may have potentially differential implications for recommendations related to different products, leading to heterogeneous impacts on capital formation. In markets for financial products where the best interest standard improves the gains from trade, or where the benefits from ameliorating conflicts exceed the costs of additional requirements, the proposed rule could result in increased retail customer demand for broker-dealer recommendations for these products from current retail customers, as well as new retail customers. To the extent that increased demand for broker-dealer recommendations for particular products leads retail customers to allocate more capital to securities markets, and given the role of broker-dealers in the capital formation process, we could expect greater demand for such products which could, in turn, promote capital formation. In contrast, for those products where the best interest standard could erode the gains from trade, the supply of broker-dealer recommendations may decline, producing the opposite effect on capital formation. At the same time, the potential decline in the supply of broker-dealer recommendations on these products may negatively impact the efficiency of portfolio allocation of those retail customers who might otherwise benefit from broker-dealer recommendations with respect to these products. In addition, a reduction in broker-dealers' propensity to recommend certain products could impair the efficiency with which capital in the economy is allocated to the corporate sector.

As discussed earlier, the mitigation measures that broker-dealers may implement to comply with the best interest obligation with respect to conflicts of interest arising from compensation arrangements with product sponsors may result in product sponsors competing over funding based on features other than compensation arrangements, such as product quality. In turn, competition among product sponsors based on product quality may result in more funding going to the higher quality products, and hence may increase capital allocation efficiency.

E. Reasonable Alternatives

The proposed rule would require broker-dealers, when recommending any securities transaction or investment strategy involving securities to a retail customer, to act in the best interest of the retail customer at the time of the recommendation and would require that broker-dealers act without placing the financial or other interest of the broker, dealer, or natural person who is an associated person of the broker or dealer making the recommendation, ahead of the retail customer's interest. In this section, a number of alternatives to proposed Regulation Best Interest are discussed, including: (1) A disclosure-only alternative; (2) a principles-based standard of conduct obligation; (3) a fiduciary standard for broker-dealers; and (4) enhanced standards akin to conditions of the BIC Exemption.[510]

1. Disclosure-Only Alternative

As an alternative to proposed Regulation Best Interest, that includes Disclosure, Care, and Conflict of Interest Obligations, the Commission could have the Disclosure Obligation alone, whereby broker-dealers would be obligated to disclose all material facts and conflicts, rather than also requiring broker-dealers to establish, maintain, and enforce policies and procedures to disclose (and mitigate) or eliminate material conflicts of interest associated with recommendations or financial incentives associated with recommendations. Under a disclosure-only alternative, broker-dealers would need to provide disclosure of material facts relating to the scope and term of the relationship, disclosure of material conflicts of interest with respect to the recommendation itself, and disclosures pertaining to broker-dealer compensation arrangements with third parties and their internal compensation structure. Relative to the current baseline of disclosure required by broker-dealers, a disclosure-only alternative would increase the amount of disclosure provided to retail customers and would bring such disclosure under the Exchange Act. Further, such enhanced disclosure could provide benefits to retail customers through increased information about material facts about the broker-dealer and customer relationship as well as potential conflicts of interest that broker-dealers may have.

Under the disclosure-only alternative, the proposed Relationship Summary and Regulatory Status Disclosure could serve as key components of any additional disclosure that would be required under the disclosure-only alternative. In our concurrent rulemaking, we propose to:[511] (1) Require broker-dealers and investment advisers to deliver to retail investors a short (*i.e.,* four page or equivalent limit if in electronic format) relationship summary[512] and (2) require broker-dealers and investment advisers, and their associated natural persons and supervised persons, respectively, to disclose in retail investor communications the firm's registration status with the Commission and an associated natural person's and supervised person's relationship with the firm (''Regulatory Status Disclosure'').[513]

Under this alternative, the overall costs to broker-dealers to comply with the requirements of the rule would be larger than those associated with currently required disclosure for broker-dealers; however, the costs to comply would likely be lower relative to proposed Regulation Best Interest.

The Commission preliminarily believes that a rule that only required the disclosure of conflicts of interest would be less effective than the proposed rule because broker-dealers would not be required to act in the best interest of their customers under the Exchange Act.[514] An alternative that only provides disclosure of conflicts of interest could therefore be less effective in increasing retail customer protection in the absence of the best interest requirement, relative to the proposed rule. Further, a disclosure-only alternative puts the burden on the retail customer to understand the disclosure and evaluate the magnitude of the conflict, without the benefit of a best interest standard of conduct of proposed Regulation Best Interest.[515] Therefore, the Commission preliminarily believes that a disclosure-only rule would be less effective in providing retail customer

[510] *See* BIC Exemption.

[511] *See* Relationship Summary Proposal.

[512] The customer or client relationship summary is being proposed as ''Form CRS.''

[513] *See* Relationship Summary Proposal.

[514] The disclosure-only alternative would not provide the Care Obligation required by proposed Regulation Best Interest, as discussed above. However, FINRA Rule 2111 would continue to set a minimum requirement regarding the advice that broker-dealers provide to their customers, and therefore, would continue to address the competency of the advice provided by the broker-dealers.

[515] Relative to the disclosure-only alternative, broker-dealers under proposed Regulation Best Interest would have to act in the best interest of their investors, comply with the Care Obligation, and would have to take actions to eliminate or disclose, and where applicable, mitigate and disclose conflicts of interest.

protection and reducing potential investor harm than proposed Regulation Best Interest.

2. Principles-Based Standard of Conduct Obligation

As an alternative, the Commission could rely on a principles-based standard of conduct, which could be developed by each broker-dealer based on its business model rather than directly requiring conduct standards. Under this alternative, broker-dealers would be required to comply with a principles-based approach to providing recommendations that are in the best interest of their customers, without expressly being subject to requirements to disclose, mitigate, or eliminate conflicts of interest. This alternative would focus on the competence of broker-dealers to provide advice and would continue to rely on SRO rules and the antifraud provisions of the federal securities laws and SRO rules to address broker-dealer conflicts. A principles-based standard of conduct would provide increased flexibility for broker-dealers to tailor their recommendations to retail customers, subject to the current obligations under the existing regulatory baseline, discussed above, to make suitable recommendations. This approach could impose lower compliance costs on regulated entities relative to the requirements of the proposed rule.

The Commission preliminarily believes that an approach that does not include the express requirements of the Disclosure, Care, or the requirements of the Conflict of Interest Obligations is likely to be less effective at reducing harm to retail customers that arises from conflicts of interest. Further, because each broker-dealer could have its own principles-based approach to meeting its care obligation under the Exchange Act, broker-dealers could interpret the standard differently. Variations in retail customer protection could make it difficult for retail customers to evaluate the standard of care offered by a broker-dealer and compare these across broker-dealers.

By contrast, Regulation Best Interest is designed to set a standard applicable to all broker-dealers. In the absence of a requirement to disclose or eliminate conflicts of interest or a requirement to mitigate financial conflicts,[516] as in proposed Regulation Best Interest, some firms may not undertake such mitigation techniques, either as they pertain to material conflicts of interest or those related to financial incentives. Therefore, the Commission preliminarily believes that a principles-based standard of conduct approach on its own, would be less effective from a retail customer protection standpoint than the proposed Regulation Best Interest. A principles-based standard of conduct that obligates broker-dealers to act in the best interest of their retail customers, without guidance on what a best interest standard entails, is only one element that is needed to reduce potential investor harm and that investor protection is likely to be enhanced with the Disclosure, Care, and Conflict of Interest Obligations in proposed Regulation Best Interest.

3. A Fiduciary Standard for Broker-Dealers

As an alternative, the Commission could impose a fiduciary standard on broker-dealers for retail customers.[517] Fiduciary standards vary among investment advisers, banks, acting as trustees or fiduciaries, or ERISA plan providers, but fiduciaries are generally required to act with a duty of care and duty of loyalty to their clients.

As discussed above, any prescribed standard of conduct, such as a fiduciary standard, can seek to address the principal-agent problem between retail customers and firms and financial professionals, whereby principals (retail customers) are concerned that their agents (firms and financial professionals) will not act in the best interest of the principal. In the context of investment advice, firms and financial professionals may have incentives (financial or otherwise) to provide advice to their retail customers that benefits the firm or the financial professional but may be suboptimal from the retail customer's perspective. For example, a financial professional might offer costly products, when low(er) cost alternatives are reasonably available, may offer affiliated or proprietary products, or may trade more or less frequently than is beneficial to the retail customer. As discussed above in the discussion of broad economic considerations, retail customers may not be able to adequately monitor the firms or financial professionals to ensure that their agents are working in the retail customer's best interest. Therefore, regardless of the type of investment professional providing the advice, that advice may be conflicted and potentially harm retail customers.

Although conflicts of interest may exist in any type of relationship, the nature of such conflicts vary depending on the type of firm or financial professional that provides the advice. Broker-dealers and registered representatives generally provide financial advice at the transactional level, and the nature of the relationship between customers and broker-dealers and the level of monitoring by broker-dealers tends to be episodic, rather than ongoing. Investment advisers and their representatives commonly provide ongoing monitoring to their clients. Because of the differences in the nature of the relationship, the conflicts that are likely to arise from broker-dealers (*e.g.,* offering mutual funds with large front-end loads or churning retail customer accounts) would be different from those that arise for many standalone investment advisers (*e.g.,* so-called ''reverse churning'') but may be the same as the conflicts faced by advisers when the advisers, affiliates, or third-party broker-dealers with which advisory personnel are associated receive compensation in a broker-dealer capacity.[518]

Over time, different bodies of laws and standards have emerged that are generally tailored to the different business models of broker-dealers and investment advisers and that provide retail customer protection specific to the relationship types and business models to which they apply. While obligations for broker-dealers and investment advisers that arose from common law may appear similar, each set of laws and obligations has emerged independently. Moreover, such differences between business models have provided retail customers with choice about the type of investment advice that they seek and how they pay for such advice.

A fiduciary standard for broker-dealers could produce greater uniformity between broker-dealers' and investment advisers' standards. A uniform fiduciary standard for broker-dealers and investment advisers could bring more uniformity to the professional standards of conduct regarding advice provided to retail customers. A uniform standard could potentially reduce certain conflicts and increase disclosure of others, thereby enhancing the quality of such advice,

[516] As discussed above, under a principles-based care obligation, broker-dealers would be required to continue to comply with the existing regulatory baseline, including disclosure obligations under the antifraud provisions of the federal securities laws.

[517] Retail customers would consist of the same set of investors as in proposed Regulation Best Interest.

[518] As discussed above, nearly 80% of investment adviser representatives are also registered representatives of broker-dealers; thus, those representatives and their firms, depending on the capacity in which the representatives provide advice, could face similar conflicts. Further, nearly 75% of total investment adviser assets under management are associated with investment advisers that have a broker-dealer affiliate. *See* Section IV.C.1.

lowering the possibility of harm to investors, and potentially reducing retail customer confusion with respect to investment advice. The Commission preliminarily believes such uniformity would likely affect the market for investment advice provided by broker-dealers; retail customer choice; costs of investment advice; and could lead to the potential loss of differentiation between two important business models, each of which can serve a valuable function for retail customers. This alternative also could have economic effects on both retail customers and the industry, particularly if payment choice, account choice, or product choice diminishes as a result. Regardless of the form of a new fiduciary standard for broker-dealers, legal certainty would be an important factor for broker-dealers and other providers of investment advice.

As discussed above, the broker-dealer and investment adviser models have emerged to meet the investing and advice needs of particular clienteles with varying needs for monitoring, advice, and services. Given the different business models, different standards have emerged to provide retail customer protection reflective of the business model. We preliminarily believe that a uniform fiduciary standard that would attempt to fit a single approach to retail customer protection to two different business models is unlikely to provide a tailored solution to the conflicts that uniquely arise for either broker-dealers or investment advisers.[519] Moreover, such an alternative would likely undermine efforts to preserve the ability of broker-dealers to employ business models that are distinct from investment advisers', and could thereby limit retail customer choice with respect to investment advice. This differentiated approach to customer protection is more likely to provide more appropriate investor protection commensurate with the risks inherent in each of those business models. The nature of retail investors' relationships with providers of financial advice is likely to differ between broker-dealers and investment advisers (*e.g.,* broker-dealers are more likely to provide advice on an episodic basis), which has led to the emergence of different regulatory regimes, each designed to address conflicts of interest that may arise as a result of a given business model. Therefore, the Commission preliminarily believes that it is appropriate to maintain separate regulatory standards for broker-dealers and investment advisers, while proposing to incorporate and go beyond existing levels of retail customer protection for broker-dealer customers through Regulation Best Interest and Form CRS Relationship Summary Disclosure.

4. Enhanced Standards Akin to Conditions of the BIC Exemption

The Commission could alternatively propose a fiduciary standard coupled with a series of disclosure and other requirements akin to the full complement of conditions of the DOL's BIC Exemption adopted in connection with the DOL Fiduciary Rule, which would apply to broker-dealers when making investment recommendations for all types of retail accounts rather than only in connection with services to retirement accounts.[520] The key conditions of the BIC Exemption are described in some detail in Section I.A.2. Below, we consider the tradeoffs to retail customers, broker-dealers, and other market participants of an alternative that would mirror the key conditions of the BIC Exemption.[521]

The alternative of requiring broker-dealers to adopt a fiduciary standard coupled with a series of disclosure and other requirements akin to the full complement of conditions of the DOL's BIC Exemption for all retail customer accounts and not solely with respect to retirement assets could likely have economic effects for broker-dealers. Given that some broker-dealers have already adopted some of the conditions of the DOL's BIC Exemption for retirement accounts and may have already implemented the conditions for non-retirement accounts, the incremental costs could be low under such an alternative. However, the incremental costs could be reduced only to the extent that broker-dealers have already begun to implement the conditions of the DOL's BIC Exemption. Further, as discussed above, some components of the DOL's BIC Exemption are already part of the broker-dealer regulatory framework; therefore, any potential economic effects associated with such conditions would be reduced.

An alternative that would impose on broker-dealers a fiduciary standard coupled with set of requirements akin to the full complement of the BIC Exemption conditions could drive up costs to retail customers of obtaining investment advice from broker-dealers, and could cause some retail customers to forgo advisory services through broker-dealers if they were priced out of the market.[522] For example, if the costs associated with complying with a set of requirements akin to the full complement of conditions under BIC Exemption are large, broker-dealers could transition away from commission-based brokerage accounts to fee-based advisory accounts. [523] To the extent that such an outcome increases the costs associated with investment advice, some retail customers may determine to exit the market for financial advice.

Alternatively, as costs of complying with a fiduciary standard coupled with a set of requirements akin to the full complement of BIC Exemption conditions increase, some broker-dealers may abandon certain subsets of retail customer accounts, which would similarly deprive some broker-dealer customers of investment advice. A set of requirements that are akin to the conditions of the BIC Exemptions, were they to be imposed upon broker-dealers for all retail customer accounts, would also likely have competitive effects for both broker-dealers and investment advisers,[524] and could cause exit or consolidation among both broker-dealers and investment advisers that provide investment advice,[525] which could further reduce the overall level of investment advice available to retail

[519] An example of a uniform fiduciary standard is the staff recommendation in the 913 Study. *See supra* note 38 and accompanying text.

[520] As discussed *supra* Section I.A.2., broker-dealers and their associated persons who provide fiduciary investment advice to retirement accounts (including ERISA-covered plans and participants, as well as IRAs) are not *required* to comply with the BIC Exemption to the extent that they are able to adopt an alternate approach to avoiding non-exempt prohibited transactions.

[521] The DOL also adopted the Impartial Conduct Standards in the Principal Transactions Exemption and certain other PTEs relating to the DOL Fiduciary Rule, see DOL Fiduciary Rule Release, *supra* note 49, 81 FR at 20991; these other PTEs operate with additional and/or different conditions from the BIC Exemption. This discussion only considers the conditions of the BIC Exemption, because it provides an example of the types of information and detail required under PTEs related to the DOL Fiduciary Rule, and we understand that most broker-dealers providing services to retirement accounts generally would rely on the BIC Exemption. As discussed above, the DOL Fiduciary Rule was vacated by the United States Court of Appeals for the Fifth Circuit on March 15, 2018. *See supra* note 51.

[522] *See* SIFMA Study. *See also* the ABA survey and the Financial Services Roundtable survey, *supra* note 456.

[523] As discussed in the baseline section, the average fees associated with broker-dealers' commission-based accounts are significantly lower than the average fees associated with fee-based accounts of registered investment advisers.

[524] Investment advisers, depending on how they are compensated, generally would not have to comply with the full set of obligations of the BIC Exemption, thereby reducing the costs to such firms, and providing incentives for broker-dealers to switch customers from transaction-based accounts to advisory accounts.

[525] In addition to competitive effects for broker-dealers and investment advisers, any change in the competitive environment is likely to have an impact on other providers of financial advice, including banks, and trust companies.

customers.[526] Further, for those broker-dealers that do not fully exit the market, implementing a set of requirements that are akin to the conditions of the BIC Exemption could lead to some broker-dealers transitioning from a broker-dealer business model to an investment adviser business model. Although this alternative could increase the competition between investment advisers and broker-dealers subject to a fiduciary standard and BIC Exemption-like conditions, any reduction in the costs of investment advice due to a potential increase in the supply of providers would like to be mitigated as the costs to broker-dealers to follow such standards would likely be large and could raise the costs associated with the provision of investment advice.[527]

The Commission preliminarily believes that requiring broker-dealers to comply with a fiduciary standard coupled with a set of requirements akin to the full complement of conditions under the BIC Exemption could impose costs on broker-dealers and impact retail customers and the market for investment advice; however, the Commission is unable to quantify the costs and benefits associated with this alternative. Moreover, the Department of Labor has a different regulatory focus than the Commission; therefore, a wholesale incorporation of conditions consistent with the BIC Exemption is not entirely consistent with the regulatory approach of the Commission.

F. Request for Comment

The Commission requests comment on all aspects of this initial economic analysis, including whether we have correctly identified the problem, its magnitude, and the set of reasonably available solutions and alternative approaches. We also request comment on whether the analysis has: (i) Identified all benefits and costs, including all effects on efficiency, competition, and capital formation; (ii) given due consideration to each benefit and cost, including each effect on efficiency, competition, and capital formation; and (iii) identified and considered reasonable alternatives to the proposed regulations. We request and encourage any interested person to submit comments regarding the proposed regulations, our analysis of the potential effects of the proposed regulations, and other matters that may have an effect on the proposed regulations. We request that commenters identify sources of data and information as well as provide data and information to assist us in analyzing the economic consequences of the proposed regulations. We also are interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we may not have discussed. We also request comment on the assumptions underlying our analysis and cost estimates.

In addition to our general request for comment on the economic analysis associated with the proposed regulations, we request specific comment on certain aspects of the proposal:

• We request comment on our characterization of the relationship between a broker-dealer and a retail customer. Do commenters agree with our principal-agent characterization of this relationship? Are there different ways of characterizing this relationship that we should consider? Is the concept of ''gains from trade'' appropriate for capturing the economic impact of the proposed regulation on the broker-dealers and their retail customers? Are there alternative economic concepts that we should consider? Is the example that illustrates how the concept of ''gains for trade'' works useful for understanding the economic impacts of the proposed regulation? Can commenters suggest alternative examples?

• We request comment on our assumptions related to identifying broker-dealers that are likely to have retail customers. If only ''sales'' activity is marked on Form BR, is it appropriate to assume that a firm has both ''retail'' and ''institutional'' sales activities?

• We request comment on the financial incentives provided by broker-dealers to registered representatives and other associated persons of the broker-dealer. Are the ranges provided reasonable? Are there other types of compensation arrangements or financial incentives that are provided to associated persons of broker-dealers, particularly registered representatives, which are not included in the baseline? Please be specific and provide data and analysis to support your views.

• We request comment on our characterization of the benefits of proposed Regulation Best Interest. We believe that the proposed rule achieves its main benefits by ameliorating the agency conflict between broker-dealers and retail customers. Do commenters agree with our characterization of the benefits? Are there other benefits of the proposed rule that have not been identified in our discussion and that warrant consideration? Are the assumptions that form the basis of our analysis of the benefits appropriate? Can commenters provide data that supports or opposes these assumptions? Can commenters provide data that would help the Commission quantify the magnitude of the benefits identified in our discussion or other benefits that we missed to identify in our discussion and that warrant consideration?

• We request comment on our characterization of the costs of the proposed Regulation Best Interest. We believe that the best interest obligation through its component obligations would impose direct costs on broker-dealers. Furthermore, we believe that depending on how broker-dealers chose to comply with the best interest obligation, the proposed rule may impose costs on retail customers. Do commenters agree with our characterization of the costs? Are there other costs of the proposed rule that have not been identified in our discussion and that warrant consideration? Are the assumptions that form the basis of our analysis of the costs appropriate? Can commenters provide data that supports or opposes these assumptions? Can commenters provide data that would help the Commission quantify the magnitude of the costs identified in our discussion or other costs that we missed to identify in our discussion and that warrant consideration?

• How do commenters anticipate that the benefits and costs of the proposed rule will be shared between broker-dealers and their retail customers? Please be specific and provide data and analysis to support your views.

• Are there any effects on efficiency, competition, and capital formation that are not identified or are misidentified in our economic analysis? Please be specific and provide data and analysis to support your views.

• What would the costs for broker-dealers be if the provision of discretionary investment advice, whether or not limited in scope, were not to be considered ''solely incidental'' to broker-dealer's business under Advisers Act rule 202(a)(11)(C)? Would there be any costs or benefits to retail customers? How would the market for the provision of financial advice change? Would dually-registered firms treat discretionary accounts as brokerage accounts?

• Do commenters believe that the alternatives the Commission considered are appropriate? Are there other reasonable alternatives that the

[526] As discussed above in Section IV.D, proposed Regulation Best Interest also could have competitive effects between broker-dealers and investment advisers.

[527] One of the main critiques of the BIC Exemption arises from the increased legal uncertainty and associated increased litigation risk for broker-dealers, as discussed above.

Commission should consider? If so, please provide additional alternatives and how their costs and benefits would compare to the proposal.

V. Paperwork Reduction Act Analysis

Certain provisions of the proposed rules and rule amendments would impose new ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[528]

The Commission is submitting the proposed rules and rule amendments to the Office of Management and Budget (''OMB'') for review and approval in accordance with the PRA.[529] The titles for these collections of information are: (1) ''Regulation Best Interest;'' (2) Rule 17a–3—Records to be Made by Certain Exchange Members, Brokers and Dealers (OMB control number 3235–0033);[530] and (3) Rule 17a–4—Records to be Preserved by Certain Brokers and Dealers (OMB control number 3235–0279).[531] OMB has not yet assigned a control number to the collection of information for ''Regulation Best Interest.'' An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

Proposed pursuant to the Commission's authority under the Dodd-Frank Act and the Exchange Act, Regulation Best Interest would: (1) Improve disclosure about the scope and terms of the broker-dealer's relationship with the retail customer, which would foster retail customers' understanding of their relationship with a broker-dealer; (2) enhance the quality of recommendations provided by establishing an express best interest obligation under the federal securities laws; (3) enhance the disclosure of a broker-dealer's material conflicts of interest; (4) and establish obligations that require mitigation, and not just disclosure, of conflicts of interest arising from financial incentives associated with broker-dealer recommendations. Generally, in crafting proposed Regulation Best Interest, we aimed to provide broker-dealers flexibility in determining how to satisfy the component obligations. For purposes of this analysis, we have made assumptions regarding how a broker-dealer would comply with the obligations of Regulation Best Interest, as well as the proposed amendments to Rule 17a–3(a)(25) and Rule 17a–4(e)(5).

A. Respondents Subject to Proposed Regulation Best Interest and Proposed Amendments to Rule 17a–3(a)(25), Rule 17a–4(e)(5)

1. Broker-Dealers

Proposed Regulation Best Interest would impose a best interest obligation on a broker-dealer when making recommendations of any securities transaction or investment strategy involving securities to ''retail customers.'' Except where noted, we have assumed that a dually-registered firm, already subject to the Investment Advisers Act, would be subject to new, distinct burdens under proposed Regulation Best Interest.

As of December 31, 2017, 3,841 broker-dealers were registered with the Commission—either as standalone broker-dealers or as dually-registered entities. Based on data obtained from Form BR, the Commission preliminarily believes that approximately 74.4% of this population, or 2,857 broker-dealers have retail customers and therefore would likely be subject to Regulation Best Interest and the proposed amendments to Rules 17a–3(a)(25) and 17a–4(e)(5).[532]

2. Natural Persons who are Associated Persons of Broker-Dealers

As with broker-dealers, proposed Regulation Best Interest would impose a best interest obligation on natural persons who are associated persons of broker-dealers, when making recommendations of any securities transaction or investment strategy involving securities to ''retail customers.''

The Commission preliminarily believes that approximately 435,071 natural persons would qualify as retail-facing, licensed representatives at standalone broker-dealers or dually-registered firms,[533] and would therefore likely be subject to proposed Regulation Best Interest, and the proposed amendments to Rules 17a–3(a)(25) and 17a–4(e)(5).[534]

B. Summary of Collections of Information

Regulation Best Interest would require broker-dealers to act in the best interest of a retail customer when recommending any securities transaction or investment strategy involving securities to a retail customer. As discussed above, proposed Regulation Best Interest would specifically provide that this best interest obligation shall be satisfied if: (1) The broker, dealer or natural person who is an associated person of a broker or dealer, prior to or at the time of a recommendation, reasonably discloses to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer, including all material conflicts of interest that are associated with the recommendation; (2) the broker, dealer or natural person who is an associated person of a broker or dealer, exercises reasonable diligence, care, skill, and prudence in making a recommendation; (3) the broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendations; and (4) the broker or dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.

Furthermore, the proposed addition of paragraph (a)(25) to Rule 17a–3 would impose new record-making obligations on broker-dealers subject to Regulation Best Interest, while the Proposed Amendment to Rule 17a–4(e)(5) would impose new record retention obligations on broker-dealers subject to Regulation Best Interest.

The obligations arising under Regulation Best Interest, the Proposed Amendment to Rule 17a–3(a)(25), and the Proposed Amendment to Rule 17a–4(e)(5) would give rise to distinct collections of information and

[528] 44 U.S.C. 3501 *et seq.*

[529] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

[530] *See* 17 CFR 240.17a–3. The proposed addition of paragraph (a)(25) to Rule 17a–3 would amend the existing PRA for Rule 17a–3.

[531] *See* 17 CFR 240.17a–4. The Proposed Amendment to Rule 17a–4(e)(5) would amend the existing PRA for Rule 17a–4.

[532] As of December 31, 2017, 3,841 broker-dealers filed Form BD. Retail sales by broker-dealers were obtained from Form BR.

[533] *See* Section IV.B.1, *supra,* at Table 5. This estimate is based on the following calculation: (494,399 total licensed representatives (including representatives of investment advisers)) × (12% (the percentage of total licensed representatives who are standalone investment adviser representatives)) = 59,328 representatives at standalone investment advisers. To isolate the number of representatives at standalone broker-dealers and dually-registered firms, we have subtracted 59,328 from 494,399, for a total of 435,071 retail-facing, licensed representatives at standalone broker-dealers or dually-registered firms.

[534] Unless otherwise noted, for purposes of the PRA, we use the term ''registered representatives'' to refer to associated persons of broker-dealers who are registered, have series 6 or 7 licenses, and are retail-facing, and we use the term ''dually-registered representatives of broker-dealers'' to refer to registered representatives who are dually-registered and are associated persons of a standalone broker-dealer (who may be associated with an unaffiliated investment adviser) or a dually-registered broker-dealer.

associated costs and burdens for broker-dealers subject to the proposed rules.

The collections of information associated with these proposed rules and proposed rule amendments are described below.

1. Conflict of Interest Obligations

Regulation Best Interest would require a broker-dealer entity [535] to establish, maintain, and enforce written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with a recommendation. Second, Regulation Best Interest would require a broker-dealer to establish, maintain, and enforce written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with a recommendation.

Written policies and procedures developed pursuant to the Conflict of Interest Obligations of proposed Regulation Best Interest would help a broker-dealer develop a process, relevant to its retail customers and the nature of its business, for identifying material conflicts of interest, and then determining whether to eliminate, or disclose and/or mitigate, the material conflict and the appropriate means of eliminating, disclosing, and/or mitigating the conflict. As a result of a broker-dealer's eliminating, disclosing, and/or mitigating the effects of conflicts of interest on broker-dealer recommendations, retail customers would more likely receive recommendations in their best interest. In addition, the retention of written policies and procedures would generally: (1) Assist a broker-dealer in supervising and assessing internal compliance with Regulation Best Interest; and (2) assist the Commission and SRO staff in connection with examinations and investigations.[536]

Following is a detailed discussion of the estimated costs and burdens associated with broker-dealers' Conflict of Interest Obligations.

a. Written Policies and Procedures

(1) Initial Costs and Burdens

We believe that most broker-dealers have policies and procedures in place to address material conflicts, but they do not necessarily have written policies and procedures regarding the identification and management of conflicts as proposed in Regulation Best Interest. To initially comply with this obligation, we believe that broker-dealers would employ a combination of in-house and outside legal and compliance counsel to update existing policies and procedures.[537] We assume that, for purposes of this analysis, the associated costs and burdens would differ between small and large broker-dealers, as large broker-dealers generally offer more products and services and therefore would need to evaluate and address a greater number of potential conflicts. Based on FOCUS Report data,[538] we estimate that, as of December 31, 2017, approximately 802 broker-dealers are small entities under the RFA. Therefore, we estimate that 2,055 broker-dealers would qualify as large broker-dealers for purposes of this analysis.[539]

As an initial matter, we estimate that a large broker-dealer would incur a one-time average internal burden of 50 hours for in-house legal and in-house compliance counsel to update existing policies and procedures to comply with Regulation Best Interest.[540] We additionally estimate a one-time burden of 5 hours for a general counsel at a large broker-dealer and 5 hours for a Chief Compliance Officer to review and approve the updated policies and procedures, for a total of 60 burden hours.[541] In addition, we estimate a cost of $4,720 for outside counsel to review the updated policies and procedures on behalf of a large broker-dealer.[542] We therefore estimate the aggregate burden for large broker-dealers to be 123,300 burden hours,[543] and the aggregate cost for large broker-dealers to be $9.70 million.[544]

In contrast, we believe small broker-dealers would primarily rely on outside counsel to update existing policies and procedures, as small broker-dealers generally have fewer in-house legal and compliance personnel. Moreover, since small broker-dealers would typically have fewer conflicts of interest, we estimate that only 40 hours of outside legal counsel services would be required to update the policies and procedures, for a total one-time cost of $18,880 [545] per small broker-dealer, and an aggregate cost of $15.1 million for all small broker-dealers.[546] We additionally believe in-house compliance personnel would require 10 hours to review and approve the updated policies and procedures, for an aggregate burden of 8,020 hours.[547]

We therefore estimate the total initial aggregate burden to be 131,320 hours,[548] and the total initial aggregate cost to be $24.8 million.[549]

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[535] As discussed above in Section II.D.3, the proposed Conflict of Interest Obligation applies solely to the broker or dealer entity, and not to the natural persons who are associated persons of a broker or dealer. For purposes of discussing the Conflict of Interest Obligation, the term ''broker-dealer'' refers only to the broker-dealer entity, and not to such individuals.

[536] Any written policies and procedures developed pursuant to proposed Regulation Best Interest would be required to be retained pursuant to Exchange Act Rule 17a–4(e)(7), which requires broker-dealers to retain compliance, supervisory, and procedures manuals (and any updates, modifications, and revisions thereto) describing the policies and practices of the broker-dealer with respect to compliance with applicable laws and rules, and supervision of the activities of each natural person associated with the broker-dealer, for a specified period of time. The record retention requirements of Rule 17a–4(e)(7) include any written policies and procedures that broker-dealers may produce pursuant to Regulation Best Interest's Conflict of Interest Obligations. The costs and burdens associated with Rule 17a–4(e)(7) will be updated in connection with the next renewal for the PRA.

[537] Throughout this PRA analysis, the burdens on in-house personnel are measured in terms of burden hours, and external costs are expressed in dollar terms.

[538] FOCUS Reports, or ''Financial and Operational Combined Uniform Single'' Reports, are monthly, quarterly, and annual reports that broker-dealers are generally required to file with the Commission and/or SROs pursuant to Exchange Act Rule 17a–5. *See* 17 CFR 240.17a–5.

[539] This calculation was made as follows: (2,857 total retail broker-dealers) − (802 small broker-dealers) = 2,055 large broker-dealers.

[540] This estimate would be broken down as follows: 40 hours for in-house legal counsel + 10 hours for in-house compliance counsel to update existing policies and procedures = 50 burden hours.

[541] This estimate is based on the following calculation: (50 hours of review for in-house legal and in-house compliance counsel) + (5 hours of review for general counsel) + (5 hours of review for Chief Compliance Officer) = 60 burden hours.

[542] Based on industry sources, Commission staff preliminarily estimates that the average hourly rate for legal services is $472/hour. This cost estimate is therefore based on the following calculation: (10 hours of review) × ($472/hour for outside counsel services) = $4,720 in outside counsel costs.

[543] This estimate is based on the following calculation: (60 burden hours of review per large broker-dealer) × (2,055 large broker-dealers) = 123,300 aggregate burden hours.

[544] This estimate is based on the following calculation: ($4,720 for outside counsel costs per large broker-dealer) × (2,055 large broker-dealers) = $9.70 million in outside counsel costs.

[545] This cost estimate is based on the following calculation: (40 hours of review) × ($472/hour for outside counsel services) = $18,880 in outside counsel costs.

[546] This cost estimate is based on the following calculation: ($18,880 for outside attorney costs per small broker-dealer) × (802 small broker-dealers) = $15.1 million in outside counsel costs.

[547] This estimate is based on the following calculation: (10 burden hours) × (802 small broker-dealers) = 8,020 aggregate burden hours.

[548] This estimate is based on the following calculation: (123,300 aggregate burden hours for large broker-dealers) + (8,020 aggregate burden hours for small broker-dealers) = 131,320 total aggregate burden hours.

[549] This estimate is based on the following calculation: ($9.70 million in aggregate costs for large broker-dealers) + ($15.1 million in aggregate costs for small broker-dealers) = $24.80 million total aggregate costs.

(2) Ongoing Costs and Burdens

For purposes of this analysis, we have assumed that small and large broker-dealers would review and update policies and procedures on a periodic basis to accommodate the addition of, among other things, new products or services, new business lines, and/or new personnel. We also assume that broker-dealers would review and update their policies and procedures for compliance with Regulation Best Interest on an annual basis, and that they would perform the review and update using in-house personnel.

For large broker-dealers with more numerous, more complex products and services, and higher rates of hiring and turnover, we estimate that each broker-dealer would annually incur an internal burden of 12 hours to review and update existing policies and procedures: Four hours for legal personnel, four hours for compliance personnel, and four hours for business-line personnel to identify new conflicts. We therefore estimate an ongoing, aggregate burden for large broker-dealers of approximately 24,660 hours.[550] Because we assume that large broker-dealers would rely on internal personnel to update policies and procedures on an ongoing basis, we do not believe large broker-dealers would incur ongoing costs.

We assume for purposes of this analysis that small broker-dealers, with fewer and less complex products, and lower rates of hiring, would mostly rely on outside legal counsel and outside compliance consultants for review and update of their policies and procedures, with final review and approval from an in-house compliance manager. We preliminarily estimate that outside counsel would require approximately five hours per year to update policies and procedures, for an annual cost of $2,360 for each small broker-dealer.[551] The projected aggregate, annual ongoing cost for outside legal counsel to update policies and procedures for small broker-dealers would be $1.89 million.[552] In addition, we expect that small broker-dealers would require five hours of outside compliance services per year to update their policies and procedures, for an ongoing cost of $1,490 per year,[553] and an aggregate ongoing cost of $1.19 million.[554] The total aggregate, ongoing cost for small broker-dealers is therefore projected at $3.08 million per year.[555]

In addition to the costs described above, we additionally believe small broker-dealers would incur an internal burden of approximately 5 hours for an in-house compliance manager to review and approve the updated policies and procedures per year. The ongoing, aggregate burden for small broker-dealers would be 4,010 hours for in-house compliance manager review.[556]

We therefore estimate the total ongoing aggregate ongoing burden to be 28,670 hours,[557] and the total ongoing aggregate cost to be $3.08 million per year.[558]

The Commission acknowledges that policies and procedures may vary greatly by broker-dealer, given the differences in size and the complexity of broker-dealer business models. Accordingly, we would expect that the need to update policies and procedures might also vary greatly.

b. Identification of Material Conflicts of Interest

(1) Initial Costs and Burdens

With respect to identifying and determining whether a material conflict of interest exists in connection with a recommendation, a broker-dealer would first need to establish mechanisms to proactively and systematically identify conflicts of interest in its business on an ongoing or periodic basis.[559] For purposes of this analysis, we understand that most broker-dealers already have an existing technological infrastructure in place, and we assume that such infrastructure would need to be modified to effect compliance with Regulation Best Interest.

Acknowledging that costs and burdens may vary greatly according to the size of the broker-dealer, we expect that the modification of a broker-dealer's existing technology would initially require the retention of an outside programmer, and that the modification of existing technology would require, on average, an estimated 20 hours of the programmer's labor, for an estimated cost per broker-dealer of $5,400.[560] We additionally project that coordination between the programmer and the broker-dealer's compliance manager would involve five burden hours. The aggregate costs and burdens for the modification of existing technology to identify conflicts of interest would therefore be $15.43 million,[561] and 14,285 burden hours.[562]

We additionally believe that the determination whether the conflicts of interest, once identified, are material, would require approximately five hours per broker-dealer,[563] for an aggregate of 14,285 burden hours for all broker-dealers.[564] The total aggregate burden for the identification of material conflicts is 28,570 hours.[565]

(2) Ongoing Costs and Burdens

To maintain compliance with Regulation Best Interest, we assume for purposes of this PRA analysis that a broker-dealer would seek to identify additional conflicts as its business evolves. The Commission recognizes that the types of services and product offerings vary greatly by broker-dealer.

[550] This estimate is based on the following calculation: (12 burden hours per large broker-dealer) × (2,055 large broker-dealers) = 24,660 aggregate ongoing burden hours.

[551] This estimate is based on the following calculation: (5 hours per small broker-dealer) × ($472/hour for outside counsel services) = $2,360 in outside counsel costs.

[552] This estimate is based on the following calculation: ($2,360 in outside counsel costs per small broker-dealer) × (802 small broker-dealers) = $1.89 million in aggregate, ongoing outside legal costs.

[553] Based on industry sources, Commission staff preliminarily estimates that the average hourly rate for compliance services in the securities industry is $298/hour. This cost estimate is based on the following calculation: (5 hours of review) × ($298/hour for outside compliance services) = $1,490 in outside compliance service costs.

[554] This estimate is based on the following calculation: ($1,490 in outside compliance costs per small broker-dealer) × (802 small broker-dealers) = $1.19 million in aggregate, ongoing outside compliance costs.

[555] This estimate is based on the following calculation: ($1.89 million for outside legal counsel costs) + ($1.19 million for outside compliance costs) = $3.08 million total aggregate ongoing costs.

[556] This estimate is based on the following calculation: (5 hours compliance manager review per small broker-dealer) × (802 small broker-dealers) = 4,010 aggregate ongoing burden hours.

[557] This estimate is based on the following calculation: (24,660 aggregate ongoing burden hours for large broker-dealers) + (4,010 aggregate ongoing burden hours for small broker-dealers) = 28,670 total aggregate ongoing burden hours.

[558] This estimate is based on the following calculation: ($3.08 million per year in total aggregate ongoing costs for small broker-dealers) + ($0 projected ongoing costs for large broker-dealers) = $3.08 million per year in total aggregate ongoing costs.

[559] *See supra* Section II.D.3.c.

[560] Based on industry sources, Commission staff preliminarily estimates that the average hourly rate for technology services in the securities industry is $270. This cost estimate is based on the following calculation: (20 hours of review) × ($270/hour for technology services) = $5,400 in outside programmer costs.

[561] This cost estimate is based on the following calculation: ($5,400 in outside programmer costs per broker-dealer) × (2,857 retail broker-dealers) = $15.43 million in aggregate outside programmer costs.

[562] This burden estimate is based on the following calculation: (5 burden hours) × (2,857 broker-dealers) = 14,285 aggregate burden hours.

[563] This burden estimate consists of 2.5 hours for review by a senior business analyst, and 2.5 hours for review by in-house compliance manager.

[564] This burden estimate is based on the following calculation: (5 burden hours) × (2,857 broker-dealers) = 14,285 aggregate burden hours.

[565] This burden estimate is based on the following calculation: (14,285 burden hours for modification of technology) + (14,285 burden hours for evaluation of conflict materiality) = 28,570 total aggregate burden hours.

However, for purposes of this analysis, we assume that broker-dealers would, at a minimum, engage in a material conflicts identification process on an annual basis.[566] We estimate that a broker-dealer's business line and compliance personnel would jointly spend, on average, 10 hours [567] to perform an annual conflicts review using the modified technology infrastructure. Therefore the aggregate, ongoing burden for an annual conflicts review, based on an estimated 2,857 retail broker-dealers, would be approximately 28,570 burden hours.[568] Because we assume that broker-dealers would use in-house personnel to identify and evaluate new, potential conflicts, we do not believe they would incur additional ongoing costs.

c. Training

Pursuant to the obligation to ''maintain and enforce'' written policies and procedures, we additionally expect broker-dealers to develop training programs that promote compliance with Regulation Best Interest among registered representatives. The initial and ongoing costs and burdens associated with such a training program are estimated below.

(1) Initial Costs and Burdens

We believe that broker-dealers would likely use a computerized training module to train registered representatives on the policies and procedures pertaining to Regulation Best Interest. We estimate that a broker-dealer would retain an outside systems analyst, an outside programmer, and an outside programmer analyst to create the training module, at 20 hours, 40 hours, and 20 hours, respectively. The total cost for a broker-dealer to develop the training module would be approximately $21,600,[569] for an aggregate initial cost of $61.7 million.[570]

Additionally, we expect that the training module would require the approval of the Chief Compliance Officer, as well as in-house legal counsel, each of whom we expect would require approximately 2 hours to review and approve the training module. The aggregate burden for broker-dealers is therefore estimated at 11,428 burden hours.[571]

In addition, broker-dealers would incur an initial cost for registered representatives to undergo training through the training module. We estimate the training time at one hour per registered representative, for an aggregate burden of 435,071 burden hours, or an initial burden of 152.3 hours per broker-dealer.[572] The total aggregate burden to approve the training module and implement the training program would be 446,699 burden hours.[573]

(2) Ongoing Costs and Burdens

We believe that, as a matter of best practice, broker-dealers would likely require registered representatives to repeat the training module for Regulation Best Interest on an annual basis. The ongoing aggregate cost for the one-hour training would be 435,071 burden hours per year, or 152.3 burden hours per broker-dealer per year.[574]

2. Disclosure Obligation

The Disclosure Obligation under proposed Regulation Best Interest would require a broker-dealer, prior to or at the time of recommending a securities transaction or strategy involving securities to a retail customer, to: (1) Reasonably disclose to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer; and (2) reasonably disclose to the retail customer, in writing, all material conflicts of interest that are associated with the recommendation. The Commission believes that requiring broker-dealers to reasonably disclose to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with a retail customer would facilitate a retail customer's understanding of the nature of his or her account, the broker-dealer's fees and charges, as well as the nature of services that the broker-dealer provides, as well as any limitations to those services. It would also reduce retail customers' confusion about the differences among certain financial service providers, such as broker-dealers, investment advisers, and dual-registrants. In addition, the obligation to disclose all material conflicts of interest associated with a recommendation would raise retail customers' awareness of the potential effects of conflicts of interest, and increase the likelihood that broker-dealers would make recommendations that are in the retail customer's best interest.

The collections of information associated with these Disclosure Obligations, as well as the associated record-making and recordkeeping obligations are addressed below.

a. Obligation To Reasonably Disclose to the Retail Customer, in Writing, the Material Facts Relating to the Scope and Terms of the Relationship With the Retail Customer

The Commission assumes for purposes of this analysis that broker-dealers would meet their obligation to reasonably disclose to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer through a combination of delivery of the Relationship Summary, creating account disclosures to include standardized language related to capacity and scope, and types of services and the development of comprehensive fee schedules.

(1) Disclosure of Capacity

As discussed above, the Commission preliminarily believes that a standalone broker-dealer would be able to satisfy its obligation to disclose that it is acting in a broker-dealer capacity by providing

[566] Analogously, FINRA rules set an annual supervisory review as a minimum threshold for broker-dealers. *See, e.g.,* FINRA Rules 3110 (requiring an annual review of the businesses in which the broker-dealer engages); 3120 (requiring an annual report detailing a broker-dealer's system of supervisory controls, including compliance efforts in the areas of antifraud and sales practices); and 3130 (requiring each broker-dealer's CEO or equivalent officer to certify annually to the reasonable design of the policies and procedures for compliance with relevant regulatory requirements).

[567] This burden estimate consists of 5 hours for review by a senior business analyst, and 5 hours for review by an in-house compliance counsel or compliance manager.

[568] This estimate is based on the following calculation: (10 hours of labor per retail broker-dealer) × (2,857 retail broker-dealers) = 28,570 aggregate burden hours.

[569] This estimate is based on the following calculation: ((20 hours of labor for a systems analyst) × ($270/hour)) + ((40 hours of labor for a programmer) × ($270/hour)) + ((20 hours of labor for a programmer analyst) × ($270/hour)) = $21,600 in external technology service costs per broker-dealer. As noted above, the $270 estimated average hourly rate for technology services is based on industry sources.

[570] This estimate is based on the following calculation: (2,857 broker-dealers) × ($21,600 cost per broker-dealer) = $61.7 million in aggregate costs for technology services.

[571] This estimate is based on the following calculation: (2,857 broker-dealers) × (4 burden hours per broker-dealer) = 11,428 burden hours.

[572] This estimate is based on the following calculation: (1 burden hour) × (435,071 registered representatives at standalone or dually-registered broker-dealers) = 435,071 aggregate burden hours. Conversely, (435,071 aggregate burden hours)/(2,857 retail broker-dealers) = 152.3 initial burden hours per broker-dealer.

[573] This estimate is based on the following calculation: (435,071 burden hours for training of registered representatives) + (11,428 burden hours to approve training program) = 446,699 total aggregate burden hours.

[574] This estimate is based on the following calculation: (1 burden hour) × (435,071 registered representatives at standalone or dually-registered broker-dealers) = 435,071 burden hours. Conversely, (435,071 aggregate burden hours)/(2,857 retail broker-dealers) = 152.3 initial burden hours per broker-dealer.

the retail customer with the Relationship Summary in the manner prescribed by the rules and guidance in the Relationship Summary Proposal.[575]

We assume, for purposes of this PRA analysis, that a dually-registered broker-dealer would satisfy its obligation to disclose it is acting in a broker-dealer capacity by creating an account disclosure with standardized language, and by providing it to the retail customer at the beginning of the relationship. The account disclosure would set forth when the broker-dealer would be acting in a broker-dealer capacity, and how the broker-dealer would notify the retail customer of any changes in its capacity. We understand that many broker-dealers already include such information in account disclosures.

(2) Disclosure of Fees, Charges, and Types/Scope of Services

While many broker-dealers do provide fee information to retail customers in a fee schedule, the Commission believes that to comply with proposed Regulation Best Interest broker-dealers would likely either amend this schedule or develop a new fee schedule to disclose the fees and charges applicable to retail customers' transactions, holdings, and accounts through the use or development of a comprehensive, standardized fee schedule. This fee schedule would be delivered to retail customers at the beginning of a relationship. If, at the time the recommendation is made, the disclosure made to the retail customer is not current or does not contain all material facts regarding the fees of the particular recommendation, the broker-dealer would need to deliver an amended fee schedule.

With respect to disclosure of the types and scope of services provided by the broker-dealer, we assume for purposes of this PRA analysis that broker-dealers would satisfy the Disclosure Obligation by including this information in the account disclosure provided to the retail customer at the beginning of the relationship, as described above. The broker-dealer would need to deliver an amended account disclosure to the retail customer in the case of any material changes made to the type and scope of services.

b. Obligation To Reasonably Disclose in Writing All Material Conflicts of Interest That Are Associated With the Recommendation

Proposed Regulation Best Interest would require a broker-dealer to reasonably disclose in writing all material conflicts of interest that are associated with a recommendation.

As discussed above, we preliminarily assume that broker-dealers would satisfy the obligation to disclose material conflicts of interest through the use of a standardized, written disclosure document provided to all retail customers and supplemental disclosure provided to certain retail customers for specific products.

We assume for purposes of this analysis that delivery of written disclosure would occur at the beginning of a relationship, such as together with the account opening agreement. For existing retail customers, the disclosure would need to occur ''prior to or at the time'' of a recommendation. Subsequent disclosures may be delivered in the event of a material change or if the broker-dealer determines additional disclosure is needed for certain types of products.

The corresponding estimated total annual reporting costs and burdens are addressed below.[576]

c. Estimated Costs and Burdens

(1) Disclosure of Capacity, Type and Scope of Services

Standalone broker-dealers would satisfy the obligation to disclose capacity through the delivery to retail customers of the Relationship Summary, in accordance with the rules and guidance set forth in the Relationship Summary Proposal. Additionally, although we understand that many dual-registrants and standalone broker-dealers, as a matter of best practice, already disclose capacity and types and scope of services to retail customers, for purposes of this analysis, we are assuming that dual-registrants would create new account disclosure related to capacity and all broker-dealers would create account disclosure related to types and scope of services specifically for purposes of compliance with Regulation Best Interest. The Commission assumes that broker-dealers would provide the account disclosure to each retail customer account, regardless of whether the retail customer has multiple accounts with the broker-dealer.

While the Commission recognizes that the Disclosure Obligation applies to the broker-dealer entity and its registered representatives, we do not expect registered representatives to incur any initial or ongoing burdens with respect to the capacity, scope and terms of the relationship, as we assume for purposes of this analysis that this information would be addressed by the broker-dealer entity's account disclosure. With regard to disclosure of capacity, the Commission believes that dually-registered representatives of broker-dealers would incur initial and ongoing burdens. Following is a discussion of the estimated initial and ongoing burdens and costs.

i. Initial Burdens and Costs

We estimate that a dually-registered firm would incur an initial internal burden of 10 hours for in-house counsel and in-house compliance personnel[577] to draft language regarding capacity for inclusion in the standardized account disclosure that is delivered to the retail customer.[578]

In addition, we estimate that dual-registrants would incur an estimated external cost of $4,720 for the assistance of outside counsel in the preparation and review of standardized language regarding capacity.[579] For the estimated 360 dually-registered firms with retail business,[580] we project an aggregate initial burden of 3,600 hours,[581] and $1.7 million in aggregate initial costs.[582]

Similarly, to comply with proposed Regulation Best Interest, standalone broker-dealers would likely draft standardized language for inclusion in the account disclosure to provide the retail customer with more specific information regarding the types and scope of services that they provide. We expect that the associated costs and burdens would differ between small and large broker-dealers, as large broker-dealers generally offer more products

[575] *See* Relationship Summary Proposal.

[576] The costs and burdens arising from the obligation to identify all material conflicts of interest that are associated with the recommendation are addressed above, in the context of the Conflict of Interest Obligation, in Section V.B.1.

[577] The 10 hour estimate includes 5 hours for in-house counsel to draft and review the standardized language, and 5 hours for consultation and review of compliance personnel.

[578] As discussed above, the following estimates include the burdens and costs that broker-dealers would incur in drafting standardized account disclosure language related to capacity, scope and terms of the relationship on behalf of their dually-registered representatives. For purposes of this analysis, the Commission assumes that broker-dealers would undertake these tasks on behalf of their registered representatives.

[579] This estimate is based on the following calculation: (10 hours for outside counsel review/drafting) × ($472/hour for outside counsel services) = $4,720 in initial outside counsel costs.

[580] *See supra* Section IV.B.1.a, at Table 1, Panel B.

[581] This estimate is based on the following calculation: (360 dually-registered retail firms) × (10 hours) = 3,600 initial aggregate burden hours.

[582] This estimate is based on the following calculation: (360 dually-registered retail firms) × ($4,720 in external cost per firm) = $1.7 million in aggregate initial costs.

and services and therefore would need to potentially evaluate a larger number of products and services.

Given these assumptions, we estimate that a small broker-dealer would incur an internal initial burden of 10 hours for in-house counsel and in-house compliance personnel to draft this standardized language.[583] In addition, a small broker-dealer would incur an estimated external cost of $4,720 for the assistance of outside counsel in the preparation and review of this standardized language.[584] For the estimated 802 small broker-dealers,[585] we project an aggregate initial burden of 8,020 hours,[586] and aggregate initial costs of $3.79 million.[587]

Given the broader array of products and services offered, we estimate that a large broker-dealer would incur an internal burden of 20 hours to draft this standardized language.[588] A large broker-dealer would also incur an estimated cost of $7,080 for the assistance of outside counsel in the preparation and review of this standardized language.[589] For the estimated 2,055 large retail broker-dealers, we estimate an aggregate initial burden of 41,100 hours,[590] and $14.55 million in aggregate initial costs.[591]

We estimate that all broker-dealers would each incur approximately 0.02 burden hour[592] for delivery of the account disclosure document.[593] Based on FOCUS data, we estimate that the 2,857 broker-dealers that report retail activity have approximately 128 million customer accounts, and that approximately 74.4%, or 95.2 million, of those accounts belong to retail customers.[594] We therefore estimate that broker-dealers would have an aggregate initial burden of 1,904,000 hours, or approximately 666 hours[595] per broker-dealer for the first year after the rule is in effect.[596]

We estimate a total initial aggregate burden for dually-registered, small and large broker-dealers to develop and deliver to retail customers account disclosures relating to capacity and type and scope of services of 1,956,620 burden hours.[597] We estimate a total initial aggregate cost of $20.04 million.[598]

ii. Ongoing Burdens

For purposes of this analysis, we assume that broker-dealers would review and amend the standardized language in the account disclosure, on average, once a year. Further, we assume that broker-dealers would not incur outside costs in connection with updating account disclosures, as in-house personnel would be more knowledgeable about changes in capacity, and the types and scope of services offered by the broker-dealer.

We estimate that each dually-registered broker-dealer would incur approximately five burden hours annually for compliance and business line personnel to review changes in the dual-registrant's capacity and types and scope of services offered, and another two burden hours annually for in-house counsel to amend the account disclosure to disclose material changes to the dual-registrant's capacity and types and scope of services offered, for a total of seven burden hours. The estimated ongoing aggregate burden to amend dual-registrants' account disclosures to reflect changes in capacity and types and scope of services would therefore be 2,520 hours.[599]

With respect to small standalone broker-dealers, we estimate an internal burden of two hours for in-house compliance and business line personnel to review and update changes in capacity and types or scope of services offered, and another two burden hours annually for in-house counsel to amend the account disclosure to disclose material changes to capacity and types or scope of services—for a total of four burden hours. The estimated ongoing aggregate burden for small broker-dealers to amend account disclosures to reflect changes in capacity and types and scope of services would therefore be 3,208 hours for small broker-dealers.[600]

We estimate that large standalone broker-dealers would incur 10 burden hours annually for in-house compliance and business line personnel to review and update changes in capacity and the types or scope of services offered, and another 10 burden hours annually for in-house counsel to amend the account disclosure to disclose material changes to capacity and the types and scope of services, for a total of 20 burden hours. We therefore believe the ongoing, aggregate burden would be 41,100 hours for large broker-dealers.[601]

With respect to delivery of the amended account agreements in the

[583] The 10 hour estimate includes 5 hours for in-house counsel to draft and review the standardized language, and 5 hours for consultation and review of compliance personnel.

[584] This estimate is based on the following calculation: (10 hours for outside counsel review/drafting) × ($472/hour for outside counsel services) = $4,720 in initial outside counsel costs.

[585] *See supra* note 538 and accompanying text.

[586] This estimate is based on the following calculation: (802 small broker-dealers) × (10 hours per small broker-dealer) = 8,020 aggregate burden hours.

[587] This estimate is based on the following calculation: (802 small broker-dealers) × ($4,720 in external cost per small retail firm) = $3.79 million in aggregate initial costs.

[588] The 20 hour estimate includes 10 hours for in-house counsel to draft and review the standardized language, and 10 hours for consultation and review of compliance personnel.

[589] This estimate is based on the following calculation: (15 hours for outside counsel review/drafting) × ($472/hour for outside counsel services) = $7,080 in initial outside counsel costs.

[590] This estimate is based on the following calculation: (2,055 large broker-dealers) × (20 burden hours) = 41,100 aggregate initial burden hours.

[591] This estimate is based on the following calculation: (2,055 large broker-dealers) × ($7,080 initial outside counsel costs) = $14.55 million in aggregate initial costs.

[592] This is the same estimate the Commission makes in the Relationship Summary Proposing Release. It is also the same estimate the Commission made in the Amendments to Form ADV Adopting Release, and for which we received no comment. *See* Amendments to Form ADV, 17 CFR parts 275 and 279 at 49259. We expect that delivery requirements will be performed by a general clerk. The general clerk's time is included in the initial burden estimate.

[593] As noted above, for new retail customers, we expect delivery to occur at the inception of the relationship; for existing customers, we expect delivery to occur prior to or at the time of a recommendation.

[594] The 2,857 broker-dealers (including dual registrants) with retail customers report 128 million customer accounts. *See* Section IV.B.1.a, Table 1, Panel B. Assuming the amount of retail customer accounts is proportionate to the percentage of broker-dealers that have retail customers, or 74.4% of broker-dealers, then the number of retail customer accounts would be 74.4% of 128 million accounts = 95.2 million retail customer accounts. This number likely overstates the number of deliveries to be made due to the double-counting of deliveries to be made by dual registrants to a certain extent, and the fact that one customer may own more than one account.

[595] These estimates are based on the following calculations: (0.02 hours per customer account × (95.2 million retail customer accounts) = 1,904,000 aggregate burden hours. Conversely, (1,904,000 hours)/(2,857 broker-dealers) = approximately 666 burden hours per broker-dealer.

[596] We estimate that broker-dealers will not incur any incremental postage costs because we assume that they will make such deliveries with another mailing the broker-dealer was already delivering to retail customers.

[597] This estimate is based on the following calculation: (3,600 aggregate initial burden hours for dual registrants) + (8,020 aggregate initial burden hours for small broker-dealers) + (41,000 burden hours for large broker-dealers) + (1,904,000 aggregate initial burden hours for all broker-dealers to deliver the account disclosures) = 1,956,620 total aggregate initial burden hours.

[598] This estimate is based on the following calculation: ($1.7 million in initial aggregate costs for dual registrants) + ($3.79 in initial aggregate costs for small broker-dealers) + ($14.55 million in initial aggregate costs for large broker-dealers) = $20.04 million in total initial aggregate costs.

[599] This estimate is based on the following calculation: (7 burden hours per dually-registered firm per year) × (360 dually-registered broker-dealers) = 2,520 ongoing aggregate burden hours.

[600] This estimate is based on the following calculation: (4 burden hours per broker-dealer per year) × (802 small broker-dealers) = 3,208 ongoing aggregate burden hours.

[601] This estimate is based on the following calculation: (20 burden hours per broker-dealer per year) × (2,055 large broker-dealers) = 41,100 ongoing aggregate burden hours.

event of material changes to the capacity disclosure or disclosure related to types and scope of services, we estimate that this would take place among 20% of a broker-dealer's retail customer accounts annually. We therefore estimate broker-dealers to incur a total annual aggregate burden of 380,800 hours, or 133 hours per broker-dealer.[602]

The total ongoing aggregate burden for dually-registered, small and large broker-dealers to review, amend, and delivery updated account disclosures to reflect changes in capacity, types and scope of services would be 427,700 burden hours per year.[603]

The Commission acknowledges that the types of services and offering of products vary greatly by broker-dealer, and therefore that the costs or burdens associated with updating the account disclosure might similarly vary.

(2) Disclosure of Fees

The Commission assumes for purposes of this analysis that a broker-dealer would disclose its fees and charges through a standardized fee schedule, delivered to the retail customer at the inception of the relationship, or, for existing retail customers, prior to or at the time of a recommendation and, as discussed below, would amend such fee schedules in the event of material changes. Although we understand that many broker-dealers already provide fee schedules to retail customers, we are assuming for purposes of this analysis that a fee schedule would be created specifically for purposes of compliance with Regulation Best Interest. While the Commission recognizes that the fee disclosure included in Disclosure Obligation applies to the broker-dealer entity and its natural associated persons, we do not expect any burdens or costs on registered representatives related to the fees and charges as this information would be addressed in the broker-dealer entity's fee schedule.

i. Initial Costs/Burdens

We assume that, for purposes of this analysis, the associated costs and burdens would differ between small and large broker-dealers, as large broker-dealers generally offer more products and services and therefore would need to potentially evaluate a wider range of fees in their fee schedules. As stated above, while we anticipate that many broker-dealers may already create fee schedules, we believe that small broker-dealers would initially spend five hours and large broker-dealers would spend ten hours to internally create a new fee schedule in consideration of the requirements of Regulation Best Interest. We additionally estimate a one-time external cost of $2,360 for smaller broker-dealers[604] and $4,720 for larger broker-dealers for outside counsel to review the fee schedule.[605] We therefore estimate the initial aggregate burden for small broker-dealers to be 4,010 burden hours,[606] and the initial aggregate cost to be $1.89 million.[607] We estimate the aggregate burden for large broker-dealers to be 20,550 burden hours,[608] and the aggregate cost to be $9.7 million.[609]

Similar to delivery of the account disclosure regarding capacity and types and scope of services, we estimate the burden for broker-dealers to make the initial delivery of the fee schedule to new retail customers, at the inception of the relationship, and existing retail customers, prior to or at the time of a recommendation, will require approximately 0.02 hours to deliver to each retail customer.[610] As stated above, we estimate that the 2,857 broker-dealers that report retail activity have approximately 128 million customer accounts, and that approximately 74.4%, or 95.2 million, of those accounts belong to retail customers.[611] We therefore estimate that a broker-dealer will have an aggregate initial burden of 380,800 hours, or approximately 133 hours per broker-dealer for the first year after the rule is in effect.[612]

The total aggregate initial burden for broker-dealers is therefore estimated at 405,360[613] hours, and the total aggregate initial cost is estimated at $11.59 million.[614]

ii. Ongoing Costs/Burdens

For purposes of this PRA analysis, we assume that broker-dealers would review and amend the fee schedule on average, once a year. With respect to small broker-dealers, we estimate that it would require approximately two hours per year to review and update the fee schedule, and for large broker-dealers, we estimate that the recurring, annual burden to review and update the fee schedule would be four hours for each large broker-dealer. Based on these estimates, we estimate the recurring, aggregate, annualized burden would be approximately 1,604 hours for small broker-dealers[615] and 8,220 hours for large broker-dealers.[616] We do not anticipate that small or large broker-dealers would incur outside legal, compliance, or consulting fees in connection with updating their standardized fee schedule since in-house personnel would be more knowledgeable about these facts, and we therefore do not expect external costs associated with updating the fee schedule.

With respect to delivery of the amended fee schedule in the event of a material change, we estimate that this would take place among 40% of a broker-dealer's retail customer accounts annually. We therefore estimate broker-dealers would incur a total annual aggregate burden of 761,600 hours, or 267 hours per broker-dealer.[617]

[602] (20%) × (95.2 million retail customer accounts) × (.02 hours for delivery to each customer account) = 380,800 aggregate burden hours. Conversely, 380,800 aggregate burden hours/2,857 broker-dealers = 133 burden hours per broker-dealer.

[603] This estimate is based on the following calculation: (2,520 ongoing aggregate burden hours for dually-registered broker-dealers) + (3,280 ongoing aggregate burden hours for small broker-dealers) + (41,100 ongoing aggregate burden hours for large broker-dealers) + (380,800 ongoing aggregate burden hours for delivery of amended account disclosures) = 427,700 total ongoing aggregate burden hours.

[604] This cost estimate is based on the following calculation: (5 hours of review) × ($472/hour for outside counsel services) = $2,360 outside counsel costs.

[605] This cost estimate is based on the following calculation: (10 hours of review) × ($472/hour for outside counsel services) = $4,720 outside counsel costs.

[606] This estimate is based on the following calculation: (5 burden hours of review per small broker-dealer) × (802 small broker-dealers) = 4,010 aggregate initial burden hours.

[607] This estimate is based on the following calculation: ($2,360 for outside counsel costs per small broker-dealer) × (802 small broker-dealers) = $1.89 million in aggregate initial outside costs.

[608] This estimate is based on the following calculation: (10 burden hours of review per large broker-dealer) × (2,055 large broker-dealers) = 20,550 aggregate initial burden hours.

[609] This estimate is based on the following calculation: ($4,720 for outside counsel costs per large broker-dealer) × (2,055 large broker-dealers) = $9.70 million in aggregate initial costs.

[610] *See supra* note 592.

[611] *See supra* note 593.

[612] This estimate is based on the following calculation: (20%) × (95.2 million retail customer accounts) × (.02 hours for delivery to each customer account) = 380,800 aggregate burden hours. Conversely, (380,800 aggregate burden hours)/(2,857 broker-dealers) = 133 burden hours per broker-dealer.

[613] This estimate is based on the following calculations: (4,010 aggregate burden hours for small broker-dealers) + (20,550 burden hours for large broker-dealers) + (380,800 burden hours for delivery) = 405,360 total aggregate initial burden hours.

[614] This estimate is based on the following calculation: ($1.89 million for small broker-dealer costs) + ($9.7 million large broker-dealer costs) = $11.59 million in total aggregate costs.

[615] This estimate is based on the following calculation: (2 burden hours per broker-dealer) × (802 small broker-dealers) = 1,604 aggregate burden hours.

[616] This estimate is based on the following calculation: (4 burden hours per broker-dealer) × (2,055 large broker-dealers) = 8,220 aggregate burden hours.

[617] This estimate is based on the following calculation: (40% of 95.2 million retail customer

Continued

The Commission acknowledges that the type of fee schedule may vary greatly by broker-dealer, and therefore that the costs or burdens associated with updating the standardized fee schedule might similarly vary.

(3) Disclosure of Material Conflicts of Interest

Regulation Best Interest would require broker-dealers to reasonably disclose all material conflicts that are associated with a recommendation. Because the Disclosure Obligation applies to both broker-dealers entity and registered representatives, the Commission expects that the broker-dealer entity and its registered representatives would incur initial and ongoing burdens. However, as with the disclosure of capacity and types and scope of services, we assume for purposes of this analysis that broker-dealers would incur the burdens and costs of disclosing material conflicts of interest on behalf of their registered representatives.

i. Initial Costs and Burdens

The Disclosure Obligation of proposed Regulation Best Interest would provide broker-dealers with the flexibility to choose the form and manner of conflict disclosure. However, we believe that many or most broker-dealers would develop a standardized conflict disclosure document and distribute it to retail customers.[618] We also assume for purposes of this PRA analysis that broker-dealers would update and deliver the standardized conflict disclosure document yearly on an ongoing basis, following the broker-dealer's annual conflicts review process.[619]

For purposes of this PRA analysis, we assume that a standardized conflict disclosure document would be developed by in-house counsel and reviewed by outside counsel. For small broker-dealers, we estimate it would take in-house counsel, on average, 5 burden hours to create the standardized conflict disclosure document and outside counsel 5 hours to review and revise the document. The initial aggregate burden for the development of a standardized disclosure document, based on an estimated 802 small broker-dealers, would be approximately 4,010 burden hours.[620] We additionally estimate an initial cost of $2,360 per small broker-dealer,[621] and an aggregate initial cost of $1.89 million for all small broker-dealers.[622]

We expect the development and review of the standardized conflict disclosure document to take longer for large broker-dealers because, as discussed above, we believe large broker-dealers generally offer more products and services and employ more individuals, and therefore would need to potentially disclose a larger number of conflicts. We estimate that for large broker-dealers, it would take 7.5 burden hours for in-house counsel to create the standardized conflict disclosure document, and outside counsel would take another 7.5 hours to review and revise the disclosure document. As a result, we estimate the initial aggregate burden, based on an estimated 2,055 large broker-dealers, to be approximately 15,413 burden hours.[623] We additionally estimate initial costs of $3,540 per broker-dealer,[624] and an aggregate cost for large broker-dealers of approximately $7.27 million.[625]

We assume that broker-dealers would deliver the standardized conflict disclosure document to new retail customers at the inception of the relationship, and to existing retail customers prior to or at the time of a recommendation. We estimate that broker-dealers would require approximately 0.02 hours to deliver the standardized conflict disclosure document to each retail customer.[626] We therefore estimate that broker-dealers would incur an aggregate initial burden of 1,904,000 hours, or approximately 666 hours per broker-dealer for delivery of the standardized conflict disclosure document the first year after the rule is in effect.[627]

ii. Ongoing Costs and Burdens

We believe that broker-dealers would incur ongoing annual burdens and costs to update the disclosure document to include newly identified conflicts. While Regulation Best Interest does not require broker-dealers to provide disclosures at specific intervals or times, but rather allows broker-dealers to provide disclosures on an as-needed basis, we assume for purposes of this analysis that broker-dealers would update their conflict disclosure document annually, after conducting an annual conflicts review. We estimate that the conflict disclosure form would be updated internally by both small and large broker-dealers.

We estimate that in-house counsel at a small broker-dealer would require approximately 1 hour per year to update the standardized conflict disclosure document, for an ongoing aggregate burden of approximately 802 hours.[628] For large broker-dealers, we estimate that the ongoing, annual burden would be 2 hours for each broker-dealer: 1 hour for compliance personnel and 1 hour for legal personnel. We therefore estimate the ongoing, aggregate burden for large broker-dealers to be approximately 4,110 burden hours.[629] We do not anticipate that small or large broker-dealers would incur outside legal, compliance, or consulting fees in connection with updating their standardized conflict disclosure document, since in-house personnel would presumably be more knowledgeable about conflicts of interest.

With respect to ongoing delivery of the updated conflict disclosure document, we estimate that this would take place among 40% of a broker-dealer's retail customer accounts annually.[630] We therefore estimate that broker-dealers would incur an aggregate

accounts) × (.02 hours) = 761,600 aggregate burden hours. Conversely, (761,600 aggregate burden hours)/(2,857 broker-dealers) = 267 burden hours per broker-dealer.

[618] As noted above, we assume that delivery for new customers would occur at the inception of the relationship, and that delivery for existing customers would occur prior to or at the time a recommendation is made.

[619] However, as discussed above, we recognize that broker-dealers might choose to disclose material conflicts of interest on an as-needed basis, and might take a layered approach to disclosure, as opposed to a standardized conflict disclosure document. We request comment on whether broker-dealers may choose to take a layered approach to disclosure and the associated costs of burdens.

[620] This estimate is based on the following calculation: (5 hours) × (802 small broker-dealers) = 4,010 aggregate burden hours.

[621] This estimate is based on the following calculation: ($472/hour) × (5 hours) = $2,360 in initial costs.

[622] This estimate is based on the following calculation: ($472/hour × 5 hours) × (802 broker-dealers) = $1.89 million in aggregate initial costs.

[623] This estimate is based on the following calculation: (7.5 hours × 2,055 large broker-dealers) = 15,413 burden hours.

[624] This estimate is based on the following calculation: ($472/hour) × (7.5 hours) = $3,540 in initial costs.

[625] This estimate is based on the following calculation: ($472/hour) × (7.5 hours × 2,055 large broker-dealers) = $7.27 million in aggregate costs.

[626] *See supra* note 592. For purposes of this PRA analysis, we have assumed any initial disclosures made by the broker-dealer related to material conflicts of interest would be delivered together.

[627] These estimates are based on the following calculations: (0.02 hours per customer account × 95.2 million retail customer accounts) = 1,904,000 aggregate burden hours. Conversely, (1,904,000 hours)/(2,857 broker-dealers) = 666 burden hours per broker-dealer.

[628] This estimate is based on the following calculation: (1 hour per broker-dealer) × (802 small broker-dealers) = 802 aggregate burden hours.

[629] This estimate is based on the following calculation: (2 hours per broker-dealer) × (2,055 large broker-dealers) = 4,110 aggregate burden hours.

[630] The Commission estimates that broker-dealers would update fees and material conflicts of interest disclosure more frequently than disclosure related to capacity or type and scope of services.

ongoing burden of 761,600 hours, or 267 burden hours per broker-dealer.[631]

3. Care Obligation

Under proposed Regulation Best Interest, prior to or at the time of making the recommendation, a broker-dealer would be required to make a reasonable effort to ascertain the potential risks and rewards associated with the recommendation, and to determine whether the recommendation could be in the best interest of at least some retail customers. However, any PRA burdens or costs associated with the Care Obligation are discussed below with respect to proposed Rule 17a–3(a)(25).

4. Record-Making and Recordkeeping Obligations

Records made and retained in accordance with the proposed amendments to Rule 17a–3(a)(25) and 17a–4(e)(5) would (1) assist a broker-dealer in supervising and assessing internal compliance with Regulation Best Interest; and (2) assist the Commission and SRO staff in connection with examinations and investigations.

The record-making and recordkeeping costs and burdens associated with the proposed amendments to Rule 17a–3(a)(25) and Rule 17a–4(e)(5) are addressed below.

a. Record-Making

Proposed Rule 17a–3(a)(25) would require a broker-dealer to make a record of all information collected from and provided to the retail customer pursuant to Proposed Regulation Best Interest. We understand that broker-dealers currently make records of relevant customer investment profile information, and we therefore assume that no additional record-making obligations would arise as a result of broker-dealers' or their registered representatives' collection of information from retail customers.[632]

In addition, the proposed amendment to Rule 17a–3(a)(25) would require a broker-dealer, ''for each retail customer to whom a recommendation of any securities transaction or investment strategy involving securities is or will be provided,'' to make a record of the ''identity of each natural person who is an associated person, if any, responsible for the account.'' We understand that broker-dealers likely make such records in the ordinary course of their business pursuant to Exchange Act Rules 17a–3(a)(6) and (7). However, we are assuming, for purposes of compliance with proposed Rule 17a–3(a)(25), that broker-dealers would need to create a record, or modify an existing record, to identify the associated person, if any, responsible for the account in the context of proposed Regulation Best Interest.

(1) Initial Costs and Burdens

We assume that broker-dealers would satisfy the record-making requirement of the proposed amendment to Rule 17a–3(a)(25) by amending an existing account disclosure document to include this information. We believe that the inclusion of this information in an account disclosure document would require, on average, approximately 1 hour per year for outside counsel at small broker-dealers, at an average rate of $472/hour, for an annual cost of $472 for each small broker-dealer to update an account disclosure document. The projected initial, aggregate cost for small broker-dealers would be $378,544.[633] For broker-dealers that are not small entities, we estimate that the initial burden would be 2 hours for each broker-dealer: 1 hour for compliance personnel and 1 hour for legal personnel. We therefore believe the initial aggregate burden for broker-dealers that are not small entities would be approximately 4,110 burden hours.[634] Finally, we estimate it would require an additional 0.04 hours for the registered representative responsible for the information (or other clerical personnel) to fill out that information in the account disclosure document, for an approximate total aggregate initial burden of 3,808,000 hours, or approximately 1,333 hours per broker-dealer for the first year after the rule is in effect.[635] Because we have already included the costs and burdens associated with the delivery of the amended account disclosure document above, we need not include them in this section of the analysis.

(2) Ongoing Costs and Burdens

We do not believe that the identity of the registered representative responsible for the retail customer's account would change. Accordingly, we believe that there are no ongoing costs and burdens associated with this record-making requirement of the proposed amendment to Rule 17a–3(a)(25).

b. Recordkeeping Obligations

For each record made pursuant to proposed Rule 17a–3(a)(25), the proposed amendment to Rule 17a–4(e)(5) would require broker-dealers to retain ''all account record information required pursuant to [Regulation Best Interest] and all records required pursuant to [Regulation Best Interest], in each case until at least six years after the earlier of the date the account was closed or the date on which the information was collected, provided, replaced, or updated.'' As discussed above, the following records would likely need to be retained pursuant to proposed Rule 17a–3(a)(25): (1) A standardized Relationship Summary document, developed in accordance with the rules and guidance contained in the Relationship Summary Proposal; (2) existing account disclosure documents; (3) a comprehensive fee schedule; and (4) disclosures identifying material conflicts.

(1) Initial Costs and Burdens

We believe that, to reduce costs and for ease of compliance, broker-dealers would utilize their existing recordkeeping systems in order to retain the forgoing records made pursuant to Regulation Best Interest, and as required to be kept under the Proposed Amendment to Rule 17a–4(e)(5). As noted above, broker-dealers currently are subject to recordkeeping obligations pursuant to Rule 17a–4, which require, for example, broker-dealers to ''preserve for a period of not less than six years, the first two years in an easily accessible place, all records required to be made pursuant to'' Rule 17a–3(a)(1), (a)(2), (a)(3), (a)(5), (a)(21), (a)(22), and analogous records created pursuant to paragraph 17a–3(f). Thus, for example,

[631] This estimate is based on the following calculation: (40% of 95.2 million retail customer accounts) × (.02 hours) = 761,600 aggregate burden hours. Conversely, (761,600 aggregate burden hours)/(2,857 broker-dealers) = 267 hours per broker-dealer.

[632] The PRA burdens and costs arising from the requirement that a record be made of all information provided to the retail customer are accounted for in proposed Regulation Best Interest and the Relationship Summary Proposal. With respect to the requirement that a record be made of all information from the retail customer, we believe that proposed Rule 17a–3(a)(25) would not impose any new substantive burdens on broker-dealers. As discussed above, we believe that the obligation to exercise reasonable diligence, care, skill and prudence would not require a broker-dealer to collect additional information from the retail customer beyond that currently collected in the ordinary course of business even though a broker-dealer's analysis of that information and any resulting recommendation would need to adhere to the enhanced best interest standard of Regulation Best Interest. *See supra* Section II.D.2.

[633] This estimate is based on the following calculation: (1 hour per small broker-dealer) × (802 small broker-dealers) × ($472/hour) = $378,544 in aggregate costs.

[634] This estimate is based on the following calculation: (2 burden hours per broker-dealer) × (2,055 large broker-dealers) = 4,110 aggregate burden hours.

[635] These estimates are based on the following calculations: (0.04 hours per customer account) × (95.2 million retail customer accounts) = 3,808,000 aggregate burden hours. Conversely, (3,808,000 burden hours)/(2,857 broker-dealers) = 1,333 hours per broker-dealer.

broker-dealers are already required to maintain documents such as account blotters and ledgers for six years.

We believe that broker-dealers would leverage their existing recordkeeping systems to include any additional or amended records required by Regulation Best Interest or pursuant to Proposed Amendment to Rule 17a–4(e)(5), and would similarly leverage their existing recordkeeping systems to account for any differences in the retention period. Thus, where broker-dealers currently retain documents on an electronic database to satisfy existing Rule 17a–4 or otherwise, we would expect broker-dealers to maintain any additional documents required by Regulation Best Interest or Proposed Amendment to Rule 17a–4(e)(5) by the same means. Likewise, where broker-dealers maintain documents required by existing Rule 17a–4 by paper, we would expect broker-dealers to continue to do so.

Based on the assumption that broker-dealers will rely on existing infrastructures to satisfy the recordkeeping obligations of Regulation Best Interest and Proposed Amendment to Rule 17–a(4)(e)(5), we believe the burden for broker-dealers to add new documents or modify existing documents to the broker-dealer's existing retention system would be approximately 15.9 million burden hours for all broker-dealers, assuming a broker-dealer would need to upload or file each of the five account documents discussed above for each retail customer account.[636] We do not believe there would be additional internal or external costs relating to the uploading or filing of the documents, nevertheless, we request comment on this assumption and whether the new requirements would pose additional costs, for example, relating to storage space for paper or relating to additional electronic database storage space. In addition, because we have already included the costs and burdens associated with the delivery of the amended account opening agreement and other documents above, we do not include them in this section of the analysis.

(2) Ongoing Costs and Burdens

We estimate that the approximate ongoing burden associated with the recordkeeping requirement of proposed amendment to Rule 17a–4(e)(5) is 3.17 million burden hours per year.[637] We do not believe that the ongoing costs associated with ensuring compliance with the retention schedule would change from the current costs of ensuring compliance with existing Rule 17a–4 and as outlined above. However, we request comment regarding both the frequency with which a broker-dealer would need to collect, provide, replace, or update the records made pursuant to the proposed amendment to Rule 17a–3(a)(25), and also on whether there would be additional costs relating to ensuring compliance with record retention and retention schedules pursuant to Rule 17a–4.

C. Collection of Information Is Mandatory

The collections of information relating to: (1) ''Regulation Best Interest;'' (2) the Proposed Amendment to Rule 17a–3—Records to be Made by Certain Exchange Members, Brokers and Dealers (OMB control number 3235–0033); and (3) the Proposed Amendment to Rule 17a–4—Records to be Preserved by Certain Brokers and Dealers (OMB control number 3235–0279) are mandatory for all broker-dealers.

D. Confidentiality

With respect to written disclosure provided to the retail customer as required by Regulation Best Interest, such disclosure would not be kept confidential. Other information provided to the Commission in connection with staff examinations or investigations would be kept confidential, subject to the provisions of applicable law.

E. Request for Comment

The Commission is using the above estimates for the purposes of calculating reporting burdens associated with Regulation Best Interest, the Proposed Amendment to Rule 17a–3 and the Proposed Amendment to Rule 17a–4. We request comment on our estimates for the new and recurring burdens and associated costs described above in connection with Regulation Best Interest. In addition to the request for comments made throughout this Section V, the Commission more generally seeks comment on its estimates as to: (1) The number of natural persons who are associated persons; (2) the number of broker-dealers that make securities-related recommendations to retail customers; (3) the number of natural persons who are associated persons that make securities-related recommendations to retail customers; and (4) any other costs or burdens associated with Regulation Best Interest that have not been identified in this release.

The Commission additionally invites comment on any other issues related to the costs and burdens associated with Regulation Best Interest. Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

• Evaluate whether the proposed collection of information is necessary for the performance of our functions, including whether the information will have practical utility;

• evaluate the accuracy of our estimates of the burdens of the proposed collections of information;

• determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and

• evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements of Regulation Best Interest should direct them to (1) the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of FOIA Services, Washington, DC 20503; and (2) Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090, with reference to File No. S7–XX–XX. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File No. S7–XX–XX, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street NE, Washington, DC 20549–0213. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VI. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of

[636] This estimate is based on the following calculation: (5 documents per customer account) × (95.2 million retail customer accounts) × (2 minutes per document)/60 minutes = 15,866,667 aggregate burden hours.

[637] This estimate is based on the percentage of account records we expect would be updated each year as described in Section V.B.2, *supra,* and the following calculation: (40% of fee schedules × 95.2 million retail customer accounts) × (2 minutes per document) + (40% of conflict disclosure forms × 95.2 million retail customer accounts) × (2 minutes per document) + (20% of account opening documents × 95.2 million retail customer accounts) × (2 minutes per document) = 3,173,334 aggregate ongoing burden hours.

1996, or ''SBREFA,'' [638] the Commission must advise the OMB as to whether the proposed regulation constitutes a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it results or is likely to result in:

• An annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);

• a major increase in costs or prices for consumers or individual industries; or

• significant adverse effect on competition, investment or innovation. If a rule is ''major,'' its effectiveness will generally be delayed for 60 days pending Congressional review.

The Commission requests comment on the potential impact of Regulation Best Interest and the Proposed Amendment to Rule 17a–4(e)(5) on:

• The U.S. economy on an annual basis,

• Any potential increase in costs or prices for consumers or individual industries, and

• Any potential effect on competition, investment, or innovation.

Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

VII. Initial Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (''RFA'') [639] requires federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a) [640] of the Administrative Procedure Act,[641] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on ''small entities.'' [642] Under Section 605(b) of the RFA, a federal agency need not undertake a regulatory flexibility analysis of proposed rules where, if adopted, they would not have a significant economic impact on a substantial number of small entities.[643]

A. Reasons for and Objectives of the Proposed Action

As discussed above in Section I, the Commission is proposing Regulation Best Interest to establish a standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer. While broker-dealers are subject to extensive existing obligations, there is no specific obligation under the Exchange Act that broker-dealers make recommendations that are in their customers' best interest. The Commission believes it is appropriate to make enhancements to the obligations that apply when broker-dealers make recommendations to retail customers.

The proposed standard of conduct is to act in the best interest of the retail customer at the time a recommendation is made without placing the financial or other interest of the broker-dealer or natural person who is an associated person making the recommendation ahead of the interest of the retail customer. This obligation shall be satisfied if: The broker-dealer or a natural person who is an associated person of a broker-dealer, before or at the time of such recommendation reasonably discloses to the retail customer, in writing, the material facts relating to the scope and terms of the relationship, and all material conflicts of interest associated with the recommendation; the broker-dealer or a natural person who is an associated person of a broker-dealer, in making the recommendation, exercises reasonable diligence, care, skill, and prudence; the broker-dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendations; and the broker-dealer establishes, maintains, and enforces written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendations.

The Commission's objectives in proposing Regulation Best Interest are to: (1) Enhance the quality of recommendations provided by broker-dealers to retail customers, by establishing under the Exchange Act a ''best interest'' care obligation that encompasses and goes beyond existing broker-dealer suitability obligations under the federal securities laws and that cannot be satisfied through disclosure alone,[644] and further establishing obligations under the Exchange Act that require mitigation, and not just disclosure, of conflicts of interest arising from financial incentives, and thus helps to reduce the potential harm resulting from such conflicts; (2) help retail customers evaluate recommendations received from broker-dealers, as well as address confusion regarding the broker-dealer relationship structure, by improving the disclosure of information regarding broker-dealer conflicts of interest and the material facts relating to scope and terms of the relationship with the retail customer; (3) facilitate more consistent regulation of substantially similar activity, particularly across retirement and non-retirement assets held at broker-dealers, and in this manner help to reduce investor confusion; (4) better align the legal obligations of broker-dealers with investors' reasonable expectations; and (5) help preserve investor choice and access to affordable investment advice and products that investors currently use. Each of these objectives is discussed in more detail in Section I.B., *supra.*

Furthermore, the proposed addition of paragraph (a)(25) to Rule 17a–3 would impose new record-making obligations on broker-dealers subject to Regulation Best Interest,[645] while the Proposed Amendment to Rule 17a–4(e)(5) would impose new record retention obligations on broker-dealers subject to Regulation Best Interest.[646]

B. Legal Basis

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act Section 913(f), Public Law 111–203, 124 Stat. 1376, 1827 (2010), and Exchange Act sections 3, 10, 15, 17, 23 and 36 thereof, 15 U.S.C. 78c, 78j, 78o, 78q, 78w and 78mm, the Commission is

[638] Public Law 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

[639] 5 U.S.C. 601 *et seq.*

[640] 5 U.S.C. 603(a).

[641] 5 U.S.C. 551 *et seq.*

[642] Although Section 601(b) of the RFA defines the term ''small entity,'' the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term small entity for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0–10 under the Exchange Act, 17 CFR 240.0–10.

[643] *See* 5 U.S.C. 605(b).

[644] *See supra* note 7.

[645] As described in Section II.E. *supra,* the Commission is proposing to amend Rule 17a–3 to add a new paragraph (a)(25), which would require, for each retail customer to whom a recommendation of any securities transaction or investment strategy involving securities is or will be provided, a record of all information collected from and provided to the retail customer pursuant to Regulation Best Interest, as well as the identity of each natural person who is an associated person of a broker or dealer, if any, responsible for the account.

[646] As described in Section II.E. *supra,* the Commission is proposing to amend Exchange Act Rule 17a–4(e)(5) to require broker-dealers to retain a record of all information collected from and provided to the retail customer pursuant to Rule 17a–3(a)(25), in addition to the existing requirement to retain information obtained pursuant to Rule 17a–3(a)(17). As a result, broker-dealers would be required to retain all of the information collected from or provided to each retail customer pursuant to Regulation Best Interest for six years.

proposing to adopt § 240.15*l*–1, to amend § 240.17a–3 by adding new paragraph (a)(25), and to revise § 240.17a–4(e)(5) of Title 17 of the Code of Federal Regulations.

C. Small Entities Subject to the Proposed Rule

For purposes of a Commission rulemaking in connection with the RFA, a broker-dealer will be deemed a small entity if it: (1) Had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a–5(d) under the Exchange Act,[647] or, if not required to file such statements, had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization.[648]

As discussed in Section V, *supra,* the Commission estimates that approximately 2,857 retail broker-dealers would be subject to Regulation Best Interest and the proposed amendment to Rules 17a–3 and 17a–4. Based on FOCUS Report data,[649] the Commission estimates that as of December 31, 2017, approximately 802 of those retail broker-dealers might be deemed small entities for purposes of this analysis.[650] For purposes of this RFA analysis, we refer to broker-dealers that might be deemed small entities under the RFA as ''small entities,'' and we continue to use the term ''broker-dealers'' to refer to broker-dealers generally, as the term is used elsewhere in this release.[651]

D. Projected Compliance Requirements of the Proposed Rule for Small Entities

The RFA requires a description of the projected reporting, recordkeeping, and other compliance requirements of proposed Regulation Best Interest and the proposed rule and rule amendments to Rules 17a–3(a)(25) and 17a–4(e)(5), including an estimate of the classes of small entities that will be subject to the requirements and the type of professional skill necessary to prepare required reports and records. Following is a discussion of the associated costs and burdens of compliance with proposed Regulation Best Interest, as incurred by small entities.

1. Conflict of Interest Obligations

As described more fully above in Section V.D.1., the Conflict of Interest Obligations would generally include the obligation to: (1) Update written policies and procedures to comply with Regulation Best Interest; (2) identify material conflicts of interest; and (3) develop a training program to maintain and enforce the policies and procedures that promote compliance with Regulation Best Interest.[652]

a. Written Policies and Procedures

To initially comply with this obligation, we believe that small entities would primarily rely on outside counsel to update existing policies and procedures. We believe that the initial costs associated with this for small entities would be $18,880 per small entity (reflecting an estimated 40 hours of outside legal counsel services), and an aggregate cost of $15.1 million for all small entities.[653] We additionally believe in-house legal counsel would require 10 hours to review and approve the updated policies and procedures, for an aggregate burden of 8,020 hours.[654] We preliminarily believe that the related ongoing costs for small entities (relating to reviewing and updating policies and procedures on a periodic basis outside) would be $3,850[655] annually for each small entity, and the projected ongoing, aggregate annualized cost for small entities (relating to outside legal counsel and outside compliance consulting services) would be $3.08 million.[656] In addition, we believe that small entities would incur approximately five hours internal burden for in-house compliance manager to review and approve the updated policies and procedures per year, for an aggregate annual burden of 4,010 hours for all small entities.[657]

b. Identification of Material Conflicts of Interest

To identify whether a material conflict of interest exists in connection with a recommendation, a small entity would need to establish mechanisms to proactively and systematically identify conflicts of interest in its business on an ongoing or periodic basis.[658] Acknowledging that costs and burdens may vary greatly according to the size of the small entity, we expect that the modification of a small entity's existing technology would initially require the retention of an outside programmer, and that the modification of existing technology would require, on average, an estimated 20 hours of the programmer's labor, for an estimated cost per small entity of $5,400.[659] We additionally project that coordination between the senior programmer and the small entity's compliance manager would involve five burden hours. The aggregate costs and burdens on small entities for the modification of existing technology to identify conflicts of interest would therefore be $4.33 million,[660] and 4,010 burden hours.[661]

We additionally believe that the determination whether the conflicts of interest, once identified, are material, would require approximately five hours per small entity,[662] for an aggregate total of 4,010 burden hours for small entities.[663]

To maintain compliance with Regulation Best Interest, we expect that a broker-dealer should seek to identify additional conflicts as its business evolves. We estimate that a small entity's business line and compliance personnel would jointly spend, on average, 10 hours[664] to perform an annual conflicts review using the modified technology infrastructure. Therefore the aggregate, ongoing burden for an annual conflicts review, based on an estimated 802 small entities, would be approximately 8,020 burden hours.[665]

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[647] *See* 17 CFR 240.17a–5(d).

[648] *See* 17 CFR 240.0–10(c).

[649] *See* note 538, *supra.*

[650] According to the FOCUS data, there are 1,040 broker-dealers that might be deemed small entities, but only 77% of those small entities (802 firms) have retail business and would be subject to Regulation Best Interest and the proposed amendments to Rules 17a–3 and 17a–4.

[651] Consistent with the PRA, unless otherwise noted, we use the terms ''registered representative'' and ''dually registered representative of a broker-dealer'' herein. *See supra* note 534.

[652] For a discussion of additional costs and burdens, as well as monetized burdens, related to the Conflict of Interest Obligation, *see supra* Section IV.C.2.d.

[653] *See supra* notes 545 and 546.

[654] *See supra* note 547.

[655] This estimate is based on the following calculation: ($2,360 for five hours of outside legal counsel review) + ($1,490 for five hours of outside compliance consulting services) = $3,850. *See supra* notes 551 and 553, and accompanying text.

[656] *See supra* note 555.

[657] *See supra* note 556.

[658] *See supra* Section V.B.1.b.(1).

[659] *See supra* note 560.

[660] This cost estimate is based on the following calculation: (20 hours of review) × ($270/hour for technology services) × (802 small entities) = $4.33 million.

[661] This burden estimate is based on the following calculation: (5 burden hours) × (802 small entities) = 4,010 burden hours.

[662] *See supra* note 563.

[663] This burden estimate is based on the following calculation: (5 burden hours) × (802 small entities) = 4,010 burden hours.

[664] *See supra* note 567.

[665] This estimate is based on the following calculation: (10 hours of labor per retail broker-dealer) × 802 small entities = 8,020 burden hours. The Commission recognizes that the types of services and product offerings vary greatly by broker-dealer. *See supra* Section V.D.1.b(2).

c. Training

Proposed Regulation Best Interest would also require a small entity to maintain and enforce its written policies and procedures. Toward this end, we expect small entities to develop training programs that promote compliance with Regulation Best Interest among registered representatives. We assume that small entities would likely use a computerized training module to train registered representatives. We estimate that a small entity would retain an outside systems analyst, an outside programmer, and an outside programmer analyst to create the training module, at 20 hours, 40 hours, and 20 hours, respectively.[666] The total cost for a small entity to develop the training module would be approximately $21,600,[667] for an aggregate cost of $17.32 million.[668]

Additionally, we expect that the training module would require the approval of the Chief Compliance Officer, as well as in-house legal counsel, each of whom we expect would require approximately 2 hours to review and approve the training module.[669] The aggregate burden for small entities would be estimated at 3,208 burden hours.[670]

In addition, small entities would incur an initial start-up cost for registered representatives to undergo training through the training module. We estimate the training time at one hour per registered representative, for a total aggregate burden of 4,236 burden hours.[671]

We assume that small entities would likely require registered representatives to repeat the training module for Regulation Best Interest on an annual basis. The ongoing aggregate cost for the one-hour training would be 4,236 burden hours per year.[672]

2. Disclosure Obligations

Pursuant to the Disclosure Obligations of proposed Regulation Best Interest, a small entity would need to: (1) Reasonably disclose to the retail customer, in writing, the material facts relating to the scope and terms of the relationship with the retail customer (including, at a minimum, disclosure of capacity, fees and charges, and types and scope of services); and (2) reasonably disclose to the retail customer, in writing, all material conflicts of interest that are associated with the recommendation. The estimated costs and burdens incurred by small entities in relation to these Disclosure Obligations are discussed in detail below.[673]

a. Disclosure of Capacity, Type and Scope of Services

We estimate that dually-registered small entities would incur an initial internal burden of ten hours for in-house counsel and in-house compliance personnel to draft language regarding capacity for inclusion in the standardized account disclosure that is delivered to the retail customer.[674] In addition, dual-registrants would incur an estimated external cost of $4,720 for the assistance of outside counsel in the preparation and review of this standardized language.[675] For the estimated 41 dually-registered small entities with retail business,[676] we project an aggregate initial burden of 410 hours,[677] and $193,520 in initial external costs.[678]

Similarly, we estimate that small entities would incur an initial burden of ten hours for in-house counsel and in-house compliance personnel to draft this standardized language.[679] In addition, small entities would incur an estimated external cost of $4,720 for the assistance of outside counsel in the preparation and review of this standardized language.[680] For the estimated 802 small entities, we project an aggregate initial burden of 8,020 hours,[681] and an initial aggregate $3.79 million in costs.[682]

We estimate that small entities would each incur approximately 0.02 burden hour for delivery of the account disclosure document.[683] Based on FOCUS data, we believe that the 802 small entities that report retail activity have a total of 10,545 customer accounts, and that approximately 74.4%, or 7,845, of those accounts belong to retail customers.[684] We therefore estimate that small entities would incur an aggregate initial burden of 156.9 hours,[685] with each small entity incurring an initial burden of 0.2 hour for the first year after the rule is in effect.

On an ongoing basis, we estimate that small entities would review and amend the standardized language in the account disclosure, on average, once a year. Further, we assume that such amendments would likely be minimal.

We estimate that each dually-registered small entity would spend approximately five hours annually for compliance and business line personnel to review changes in its capacity and types and scope of services offered, and another two hours annually for in-house counsel to amend the account disclosure to disclose material changes to the broker-dealer's capacity and types and scope of services offered, for a total of seven hours. The estimated ongoing aggregate burden would therefore 287 hours for small entity dual-registrants capacity.[686]

With respect to small entity standalone broker-dealers, we estimate they would spend two for in-house compliance and business personnel to review and update changes in capacity or the types or scope of services offered, and we estimate another two hours annually for in-house counsel to amend the account disclosure to disclose material changes to capacity or the types or scope of services for small entities—for a total of four hours. The estimated ongoing aggregate burden would therefore be 3,208 hours for small

[666] *See supra* Section V.B.1.c.(1).

[667] *See supra* note 569.

[668] This estimate is based on the following calculation: (802 small entities) × ($21,600 cost per broker-dealer) = $17.32 million.

[669] *See supra* Section V.B.1.c.(1).

[670] This estimate is based on the following calculation: (802 small entities) × (4 burden hours per small entity) = 3,208 burden hours.

[671] This estimate is based on the following calculation: (1 burden hour) × (4,236 registered representatives at small entities) = 4,236 burden hours. *See supra* note 572.

[672] This estimate is based on the following calculation: (1 burden hour) × (4,236 registered representatives at small entities) = 4,236 burden hours.

[673] For a discussion of additional costs and burdens, as well as monetized burdens, related to the Disclosure Obligation, *see supra* Section IV.C.2.b.

[674] *See supra* note 577 and 578.

[675] *See supra* note 579.

[676] This estimate is based on FOCUS data. *See supra* note 538.

[677] This estimate is based on the following calculation: (41 dually-registered small entities) × (10 burden hours) = 410 aggregate burden hours.

[678] This estimate is based on the following calculation: (41 dually-registered small entities) × ($4,720 in costs per small entity) = $193,520 in aggregate initial costs.

[679] *See supra* note 583.

[680] *See supra* note 584.

[681] *See supra* note 586.

[682] *See supra* note 587.

[683] *See supra* note 593.

[684] *See supra* note 594. Assuming the percentage of retail customer accounts at small broker-dealers is consistent with the percentage of retail customer accounts at all broker-dealers, then the number of retail customer accounts would be 74.4% of 10,545 accounts = 7,845 accounts. This number might overstate the number of deliveries to be made due to the double-counting of deliveries to be made by dual registrants to a certain extent, and the fact that one customer may own more than one account.

[685] This estimate is based on the following calculation: (.02 hour) × (7,845 retail customer accounts) = 156.9 hours (aggregate)/802 small entities = 0.2 hour per small entity. We estimate that small entities will not incur any incremental postage costs because we assume that they will make such deliveries with another mailing the broker-dealer was already delivering to customers.

[686] This estimate is based on the following calculation: (7 hours per small entity per year) × (41 dually-registered small entities) = 287 hours.

entities for types and scope of services.[687]

With respect to delivery of the amended account agreements in the event of material changes to the capacity disclosure or disclosure related to type and scope of services, we estimate that this would take place among 20% of a small entity's retail customer accounts annually. We therefore estimate that small entities would incur an aggregate burden of 313.8 hours,[688] or .39 hours per small entity.[689]

b. Disclosure of Fees

As stated above, we believe that small entities would initially spend five hours to internally create a new fee schedule in consideration of the requirements of Regulation Best Interest. We additionally estimate a one-time external cost of $2,360 for small entities for outside counsel to review the fee schedule.[690] We therefore estimate the initial aggregate burden for small entities to be 4,010 burden hours,[691] and the aggregate cost to be $1.89 million.[692]

Similar to delivery of the account disclosure document related to capacity and types and scope of services, we estimate the burden for small entities to make the initial delivery of the fee schedule to new retail customers, at the inception of the relationship, and existing retail customers, prior to or at the time of a recommendation, will require approximately 0.02 hour to deliver to each retail customer.[693] As stated above, we estimate that the 802 small entities that report retail activity have approximately 7,845 retail customer accounts. We estimate that small entities will have an aggregate initial burden of 156.9 hours,[694] or a burden of approximately 0.19 hour per small entity for the first year after the rule is in effect.[695]

We also assume that small entities would review and amend the fee schedule, on average, once a year. We estimate that each small entity would require approximately two hours per year to review and update the fee schedule. Based on this estimate, we project the recurring, aggregate, annualized burden to be approximately 1,604 hours for small entities.[696] We do not anticipate that small entities would incur outside legal, compliance, or consulting fees in connection with updating their standardized fee schedule since in-house personnel would be more knowledgeable about these facts, and therefore do not expect external costs associated with updating the fee schedule.

With respect to delivery of the amended fee schedule in the event of a material change, we estimate that this would take place among 40% of a small entity's retail customer accounts annually. We therefore estimate that small entities would incur a total annual aggregate burden of 62.76 hours, or 0.07 hour per small entity.[697]

c. Disclosure of Material Conflicts of Interest

For purposes of this analysis, we assume that small entities would use in-house counsel and outside counsel to develop a standardized conflict disclosure a document for delivery to retail customers. We estimate it would take in-house counsel for small entities, on average, 5 burden hours to create the standardized disclosure document, and that outside counsel would require 5 hours to review and revise the standardized disclosure document. The initial aggregate burden for the development of a standardized disclosure document, based on an estimated 802 small entities, would be approximately 4,010 burden hours.[698] The initial external cost for a small entity is estimated at $2,360 per small entity.[699] The aggregate, initial external cost for the development of a standardized conflict disclosure document, based on an estimated 802 small entities, would be approximately $1.89 million.[700]

We assume that small entities would initially deliver the standardized conflict disclosure document to new retail customers at the inception of the relationship, and to existing retail customers prior to or at the time of a recommendation. We estimate that small entities would require approximately 0.02 hours to deliver the standardized conflict disclosure document to each retail customer.[701] We therefore estimate that small entities would incur an aggregate initial burden of 156.9 hours [702] for delivery of the standardized conflict disclosure document, or 0.19 hour per small entity.

On an ongoing basis, we believe that small entities would incur burdens and costs to update the standardized conflict disclosure document to include newly identified conflicts annually. We assume small entities would rely on in-house counsel and in-house compliance personnel to update the disclosure document. We do not anticipate that small entities would incur outside legal, compliance, or consulting costs in connection with updating the disclosure document, since in-house personnel would presumably be more knowledgeable about material conflicts of interest.

We estimate that small entities would require approximately 1 hour per year, for a recurring, aggregate burden of approximately 802 hours per year [703] to update the standardized conflict disclosure document.

With respect to the ongoing costs and burdens of delivering the amended conflict disclosure document, we estimate that this would take place among 40% of a small entity's retail customer accounts annually.[704] We therefore estimate that small entities would incur an annual aggregate burden of 62.76 burden hours, or 0.07 burden hour per small entity.[705]

3. Obligation To Exercise Reasonable Diligence, Care, Skill and Prudence

As discussed above in Section V.B.3., we believe that the obligation to exercise reasonable diligence, care, skill and prudence in making a

[687] *See supra* note 600.

[688] This estimate is based on the following calculation: (20%) × (7,845 total small entity retail customer accounts) × (.02 hours) = 313.8 hours.

[689] This estimate is based on the following calculation: (313.8 hours aggregate)/802 small entity broker-dealers = 0.39 hour.

[690] *See supra* note 604.

[691] *See supra* note 606.

[692] *See supra* note 607.

[693] *See supra* note 592.

[694] This estimate is based on the following calculation: (.02 hour per account) × (7,845 total small entity retail customer accounts) = 156.9 hours.

[695] These estimates are based on the following calculations: (156.9 aggregate hours)/802 small broker-dealers = 0.19 hours per small broker-dealer.

[696] *See supra* note 615.

[697] 40% of 7,845 retail customer accounts × .02 hours = 62.76 aggregate hours. (62.76 hours)/(802 broker-dealers) = 0.07 hour per broker-dealer.

[698] This estimate is based on the following calculation: (5 hours) × (802 small entities) = 4,010 aggregate burden hours.

[699] This estimate is based on the following calculation: ($472/hour) × (5 hours) = $2,360 in costs.

[700] This estimate is based on the following calculation: ($472/hour × 5 hours) × (802 small entities) = $1.89 million in aggregate costs.

[701] *See supra* note 592. We have assumed any initial disclosures made by the small entity related to material conflicts of interest would be delivered together, and therefore have not included delivery costs for initial delivery.

[702] This estimate is based on the following calculation: (0.02 hour) × (7,845 retail customer accounts at small entities) = 156.9 aggregate burden hours. Conversely, (156.9 burden hours)/(802 small entities) = 0.19 burden hour per small entity.

[703] This estimate is based on the following calculation: (1 hour per small entity) × (802 small entities) = 802 aggregate burden hours.

[704] The Commission estimates that small entities would update disclosures regarding fees and material conflicts of interest more frequently than the disclosure related to capacity or type and scope of services.

[705] This estimate is based on the following calculation: (40% of 7,845 retail customer accounts at small entities) × (0.02 hours) = 62.76 burden hours. Conversely, (62.76 burden hours)/(802 small entities) = 0.07 hour per small entity.

recommendation would not impose additional costs or burdens on small entities.[706]

4. Record-Making and Recordkeeping Obligations

Small entities' record-making and recordkeeping costs and burdens associated with the proposed amendments to Rule 17a–3(a)(25) and Rule 17a–4(e)(5) are addressed below.[707]

a. Record-Making Obligations

Proposed Rule 17a–3(a)(25) would require a broker-dealer (including small entities) to make a record of all information collected from and provided to the retail customer pursuant to Proposed Regulation Best Interest. We understand that small entities currently make records of relevant customer investment profile information, and we therefore assume that no additional record-making obligations would arise as a result of small entities' collection of information from retail customers.[708]

In addition, the proposed amendment to Rule 17a–3(a)(25) would require a small entity, ''for each retail customer to whom a recommendation of any securities transaction or investment strategy involving securities is or will be provided,'' to make a record of the ''identity of each natural person who is an associated person, if any, responsible for the account.'' We understand that small entities likely make such records in the ordinary course of their business pursuant to Exchange Act Rules 17a–3(a)(6) and (7). However, we are assuming, for purposes of compliance with proposed Rule 17a–3(a)(25), that broker-dealers would need to create a record, or modify an existing record, to identify the associated person, if any, responsible for the account in the context of proposed Regulation Best Interest.

We believe that small entities would satisfy the record-making requirement of the proposed amendment to Rule 17a–3(a)(25) by amending an existing account disclosure document to include this information. We believe that the inclusion of this information in the account disclosure document would require, on average, approximately 1 hour per year for outside counsel at small entities, at an average rate of $472/hour, for an annual cost of $472 for each small entity. The projected initial aggregate cost for small entities would be $378,544.[709] Finally, we estimate it would require an additional 0.04 hour for the registered representative responsible for the account (or other clerical personnel) to fill out that information in the account disclosure document, for an estimated total aggregate initial burden of 313.8 hours, or approximately 0.39 hour per small entity for the first year after the rule is in effect.[710] Because we have already included the costs and burdens associated with the delivery of the account disclosure document above, we need not include them in this section of the analysis.

We do not believe that the identity of the associated person responsible for the retail customer's account would change. Accordingly, there are no ongoing costs and burdens associated with this record-making requirement of the proposed amendment to Rule 17a–3(a)(25).

b. Recordkeeping Obligations

As described in more detail in Section V.B.4., the following records would likely need to be retained for ''six years after the earlier of the date the account was closed or the date on which the information was collected, provided, replaced, or updated'' pursuant to proposed Rule 17a–3(a)(25): (1) A standardized Relationship Summary document, developed in accordance with the rules and guidance contained in the Relationship Summary Proposal; (2) account disclosure documents; (3) comprehensive fee schedule; and (4) disclosures identifying material conflicts.

We believe that small entities would utilize existing recordkeeping systems in order to retain the records made pursuant to Regulation Best Interest, as required under the Proposed Amendment to Rule 17a–4(e)(5). We believe the initial burden for small entities to add new documents or modified documents to their existing retention systems would be approximately 1,307.5 hours.[711] We do not believe there would be initial costs relating to the uploading or filing of the documents.[712]

We estimate that the approximate ongoing burden associated with the proposed amendment to Rule 17a–4(e)(5) would be 261.5 burden hours per year for small entities.[713] As explained above, we do not believe the ongoing costs associated with the proposed amendment to Rule 17a–4(e)(5) would change from small entities' current costs of compliance with existing Rule 17a–4.[714]

E. Duplicative, Overlapping, or Conflicting Federal Rules

An analysis under the RFA requires a federal agency to identify, to the extent practicable, all relevant federal rules that may duplicate, overlap or conflict with the proposed rule. As discussed above, the existing regulatory regime for broker-dealers includes the DOL Fiduciary Rule and related PTEs, in particular, the obligations that the BIC Exemption and the Principal Transactions Exemption would impose.[715] However, we believe that the principles underlying Regulation Best Interest would not conflict with and are generally consistent with the principles underlying the DOL's approach under the DOL Fiduciary Rule and the related PTEs, specifically the BIC Exemption and the Principal Transactions Exemption.

F. Significant Alternatives

An RFA analysis requires a discussion of alternatives to the proposed rule that would minimize the impact on small entities while accomplishing the stated

[706] For a discussion of additional costs and burdens, as well as monetized burdens, related to the Care Obligation, *see supra* Section IV.C.2.c.

[707] For a discussion of additional costs and burdens, as well as monetized burdens, related to Record-making and Recordkeeping, *see supra* Section IV.C.2.c.

[708] As discussed above, we believe that the obligation to exercise reasonable diligence, care, skill and prudence would not require a small entity to collect additional information from the retail customer beyond that currently collected in the ordinary course of business, although a small entity's analysis of that information and any resulting recommendation would need to adhere to the enhanced best interest standard of Regulation Best Interest. *See supra* Section II.D.2.

[709] This estimate is based on the following calculation: (1 hour per small entity) × (802 small entities) × ($472/hour) = $378,544 in aggregate costs.

[710] These estimates are based on the following calculations: (0.04 hour per customer account) × (7,845 customer accounts) = 313.8 aggregate burden hours. Conversely, (313.8 aggregate burden hours)/(802 small entities) = approximately 0.39 hour per small entity.

[711] This estimate is based on the following calculation: (5 documents per retail customer account) × (7,845 retail customer accounts at small entities) × (2 minute per document) = 78,450 minutes/60 minutes = 1,307.5 burden hours. *See supra* note 636.

[712] As noted above, we request comment on this assumption and whether the new requirements would pose additional costs.

[713] This estimate is derived from the percentage of records that we expect to be updated annually, as described in Section V.B.2. above, and based on the following calculation: (40% of fee schedules × 7,845 retail customer accounts) × (2 minutes per document) + (40% of conflict disclosures × 7,845 retail customer accounts) × (2 minutes per document) + (20% of account opening documents × 7,845 retail customer accounts) × (2 minutes per document) = 7,845 minutes/60 minutes = 261.5 burden hours.

[714] As noted above, we request comment regarding both the frequency with which a broker-dealer would need to collect, provide, replace or update the records made pursuant to the proposed amendment to Rule 17a–3(a)(25), and also whether there would be additional costs relating to ensuring compliance with the record retention and retention schedules pursuant to Rule 17a–4.

[715] *See, e.g., supra* Sections I.A.2, II.B.1.a.

objectives of the applicable statutes. The analysis should include: (1) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for such small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part thereof, for such small entities.

The Commission preliminarily does not believe that exempting any subset of broker-dealers, including broker-dealers that are small entities, from proposed Regulation Best Interest and the proposed amendments to Rules 17a–3 and 17a–4(e)(5) would permit us to achieve our stated objectives. We also do not believe it would be desirable to establish different requirements applicable to broker-dealers of different sizes to account for resources available to small entities.

As discussed above, we believe that the proposal would result in multiple investor protection benefits, and these benefits should apply to retail customers of smaller entities as well as retail customers of large broker-dealers. For example, a primary objective of this proposal is to enhance the quality of recommendations provided by broker-dealers to retail customers, by establishing under the Exchange Act a ''best interest'' obligation. We do not believe that the interest of investors who are retail customers would be served by exempting broker-dealers that are small entities from proposed Regulation Best Interest and the proposed amendments to Rules 17a–3 and 17a–4(e)(5) or subjecting these broker-dealers to different requirements than larger broker-dealers.[716]

Moreover, providing an exemption or different requirements for small entities would be inconsistent with our goal of facilitating more consistent regulation, in recognition of the importance for both investors and broker-dealers of having the applicable standards for brokerage recommendations be clear, understandable, and as consistent as possible across a brokerage relationship (*i.e.,* whether for retirement or non-retirement purposes) and better aligned with other advice relationships (*e.g.,* a relationship with an investment adviser).[717] Further, as discussed above, broker-dealers are subject to regulation under the Exchange Act and the rules of each SRO of which the broker-dealer is a member, including a number of obligations that attach when a broker-dealer makes a recommendation to a customer, as well as general and specific requirements aimed at addressing certain conflicts of interest. We note that these existing requirements do not generally distinguish between small entities and other broker-dealers.

For the same reasons, we do not believe that the clarification, consolidation, or simplification of compliance and reporting requirements would be appropriate for small entities. We note, however, in crafting proposed Regulation Best Interest, we generally aimed to provide broker-dealers flexibility in determining how to satisfy the component obligations. For example, under proposed Regulation Best Interest, broker-dealers would have the flexibility to establish systems that are tailored to their business models, and to focus on specific areas of their business that pose the greatest risk of violating the Conflict of Interest Obligations. For instance, small entities without conflicting business interests would require much simpler policies and procedures than large broker-dealers that, for example, have multiple potential conflicts as a result of their other lines of business or their affiliations with other financial service firms.[718] Similarly, by not mandating the form, specific timing, or method for delivering disclosure pursuant to the Disclosure Obligation, we aim to provide broker-dealers flexibility in determining how to satisfy the Disclosure Obligation depending on each broker-dealer's business practices, consistent with the principles set forth *supra* Section II.D.1.c, and in line with the suggestion of some commenters that stressed the importance of allowing broker-dealers to select the form and manner of delivery of disclosure.[719] We believe that this flexibility reflects a general performance-based approach, rather than design-based approach in the proposal.

The Commission also considered a number of potential regulatory alternatives to proposed Regulation Best Interest, including: (1) A disclosure-only alternative; (2) a principles-based standard of conduct obligation; (3) a fiduciary standard for broker-dealers; and (4) an enhanced standard akin to conditions of the BIC Exemption. For a more detailed discussion of these regulatory alternatives, see Section IV.E., *supra*.

1. Disclosure-Only Alternative

As an alternative, the Commission could have only the Disclosure Obligation, whereby broker-dealers would be obligated to disclose all material facts and conflicts.[720] Under this alternative, the overall costs to small entities to comply with the requirements of the rule would be larger than those associated with currently required disclosure for broker-dealers in general, and such entities; however, the costs to comply would likely be lower relative to proposed Regulation Best Interest.

For a number of reasons, the Commission preliminarily believes that a rule that only required the disclosure of conflicts of interest would be less effective than the proposed rule because broker-dealers (including small entities) would not be required to act in the best interest of their customers when making recommendations, including by complying with the specific components of the Care Obligation and mitigating material conflicts of interest arising from financial incentives, and it would therefore be less effective at providing retail customer protection and reducing potential investor harm than proposed Regulation Best Interest.[721]

2. Principles-Based Alternative

As an alternative, the Commission could rely on a principles-based standard of conduct, which could be developed by each broker-dealer based on their business model without directly requiring conduct standards.[722] A principles-based standard of conduct would provide increased flexibility for small entities to tailor their

[716] *See, e.g.,* PIABA Letter (''Firms overcharge investors, recommend higher fee share classes, recommend replacements of existing mutual funds and annuities, and recommend complex products with opaque fee structures. This conduct is not limited to one sector of the brokerage industry—it occurs in firms both large and small. Note further that the violations carry across the broad spectrum of investment types.'').

[717] *See supra* note 80 and accompanying text.

[718] *See Compliance Programs of Investment Companies and Investment Advisers,* Advisers Act Release No. 2204 (Dec. 17, 2003), *available at https://www.sec.gov/divisions/investment/advoverview.htm. See also* RAND Study (reporting that the more numerous smaller firms tended to provide a more limited and focused range of either investment advisory or brokerage services, and the larger firms tended to engage in a much broader range of products and services, offering both investment advisory and brokerage services).

[719] *See supra* note 206.

[720] As described more fully in Section IV.E., *supra,* under the disclosure-only alternative, the proposed Relationship Summary and Regulatory Status Disclosure could serve as key components of any additional disclosure that would be required under the disclosure-only alternative.

[721] *See supra* Section IV.E.

[722] As discussed above, under a principles-based care obligation, broker-dealers would be required to continue to comply with the existing regulatory baseline, including disclosure obligations under the antifraud provisions of federal securities laws.

TAB 3

Table 5 to paragraph (i)(3) of this AD—Front Wing Attachment, Fuselage Side, Reinforcement Modification

Airplane Models	MSN and Configuration	Compliance Time
TB 9 TB 10	MSN 001 to 399 and 413 airplanes that do not have SOCATA Technical Instruction OPT10-9081-53 (Kit OPT908100) installed	Before or upon accumulating 6,000 landings on the airplane.
	MSN 001 to 399 and 413 airplanes that do have SOCATA Technical Instruction OPT 10-9081-53 (Kit OPT908100) installed	Before or upon accumulating 12,000 landings on the airplane.
TB 9	MSN 400 to 412 and 414 to 2229	
TB 10	MSN 400 to 412, 414 to 803, 805, 806, 809 to 815, and 820 to 822	

(4) Before or upon accumulating 12,000 landings after the reinforcement modification required in paragraph (i)(2) or (3) of this AD, replace the reinforced front attachment on the fuselage side following the Description of Accomplishment Instructions in SOCATA Daher Service Bulletin SB 10–081, Revision 3, December 2017.

(j) Replacement of the Reinforced Front Attachment

Replacement of the reinforced front attachment on the wing side and/or replacement of the reinforced front attachment on the fuselage side, does not terminate the inspections required in paragraphs (h)(1) and (i)(1) of this AD. After replacement, the initial and repetitive inspection cycle starts over.

(k) Credit for Previous Actions

This AD allows credit for the initial inspection required in paragraphs (g)(1) and (i)(1) of this AD and any replacement that may have been required based on the initial inspection, if done before the effective date of this AD, following Socata Service Bulletin No. SB 10–081–57, Revison 1, dated August 1996 or Revision 2, dated January 2017. Any inspections or replacements done after the effective date must be done following SOCATA Daher Service Bulletin SB 10–081, Revision 3, December 2017 as specified in the Actions and Compliance of this AD.

(l) Other FAA AD Provisions

The following provisions also apply to this AD:

(1) *Alternative Methods of Compliance (AMOCs):* The Manager, Small Airplane Standards Branch, FAA, has the authority to approve AMOCs for this AD, if requested using the procedures found in 14 CFR 39.19. Send information to ATTN: Albert Mercado, Aerospace Engineer, FAA, Small Airplane Standards Branch, 901 Locust, Room 301, Kansas City, Missouri 64106; telephone: (816) 329–4119; fax: (816) 329–4090; email: *albert.mercado@faa.gov*. Before using any approved AMOC on any airplane to which the AMOC applies, notify your appropriate principal inspector (PI) in the FAA Flight Standards District Office (FSDO), or lacking a PI, your local FSDO.

(2) *Contacting the Manufacturer:* For any requirement in this AD to obtain corrective actions from a manufacturer, the action must be accomplished using a method approved by the Manager, Small Airplane Standards Branch, FAA; or the European Aviation Safety Agency (EASA).

(m) Related Information

Refer to MCAI EASA No. 2018–0030, dated January 31, 2018; and Daher Service Bulletin SB 10–081, Revision 3, dated December 2017, for related information. You may examine the MCAI on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2018–0326. For service information related to this AD, contact SOCATA, Direction des services, 65921 Tarbes Cedex 9, France; phone: +33 (0) 5 62 41 73 00; fax: +33 (0) 5 62 41 76 54; email: *info@socata.daher.com*; internet: *https://www.mysocata.com/login/accueil.php*. You may review copies of the referenced service information at the FAA, Policy and Innovation Division, 901 Locust, Kansas City, Missouri 64106. For information on the availability of this material at the FAA, call (816) 329–4148.

Issued in Kansas City, Missouri, on April 30, 2018.

Melvin J. Johnson,

Deputy Director, Policy & Innovation Division, Aircraft Certification Service.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

[Release No. IA–4889; File No. S7–09–18]

RIN 3235–AM36

Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation

AGENCY: Securities and Exchange Commission.

ACTION: Proposed interpretation; request for comment.

SUMMARY: The Securities and Exchange Commission (the ‘‘SEC’’ or the ‘‘Commission’’) is publishing for comment a proposed interpretation of the standard of conduct for investment

advisers under the Investment Advisers Act of 1940 (the ''Advisers Act'' or the ''Act''). The Commission also is requesting comment on: Licensing and continuing education requirements for personnel of SEC-registered investment advisers; delivery of account statements to clients with investment advisory accounts; and financial responsibility requirements for SEC-registered investment advisers, including fidelity bonds.

DATES: Comments should be received on or before August 7, 2018.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

• Use the Commission's internet comment form (*http://www.sec.gov/rules/interp.shtml*); or

• Send an email to *rule-comments@sec.gov.* Please include File Number S7–09–18 on the subject line.

Paper Comments

• Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7–09–18. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (*http://www.sec.gov/rules/interp.shtml*). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make publicly available.

Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Jennifer Songer, Senior Counsel, or Sara Cortes, Assistant Director, at (202) 551–6787 or *IArules@sec.gov,* Investment Adviser Regulation Office, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–8549.

SUPPLEMENTARY INFORMATION: The Commission is publishing for comment a proposed interpretation of the standard of conduct for investment advisers under the Advisers Act [15 U.S.C. 80b].[1]

Table of Contents

I. Introduction

An investment adviser is a fiduciary, and as such is held to the highest standard of conduct and must act in the best interest of its client.[2] Its fiduciary obligation, which includes an affirmative duty of utmost good faith and full and fair disclosure of all material facts, is established under federal law and is important to the Commission's investor protection efforts.[3] The Commission also regulates broker-dealers, including the obligations that broker-dealers owe to their customers. Investment advisers and broker-dealers provide advice and services to retail investors and are important to our capital markets and our economy more broadly. Broker-dealers and investment advisers have different types of relationships with their customers and clients and have different models for providing advice, which provide investors with choice about the levels and types of advice they receive and how they pay for the services that they receive.

Today, the Commission is proposing a rule that would require all broker-dealers and natural persons who are associated persons of broker-dealers to act in the best interest of retail customers[4] when making a recommendation of any securities transaction or investment strategy involving securities to retail customers (''Regulation Best Interest'').[5] We are also proposing to require registered investment advisers and registered broker-dealers to deliver to retail investors a relationship summary, which would provide these investors with information about the relationships and services the firm offers, the standard of conduct and the fees and costs associated with those services, specified conflicts of interest, and whether the firm and its financial professionals currently have reportable legal or disciplinary events.[6] In light of the comprehensive nature of our proposed set of rulemakings, we believe it would be appropriate and beneficial to address in one release[7] and reaffirm—and in some cases clarify—certain aspects of the fiduciary duty that an investment adviser owes to its clients under section 206 of the Advisers Act.[8]

An investment adviser's fiduciary duty is similar to, but not the same as, the proposed obligations of broker-

[1] 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified, and when we refer to rules under the Advisers Act, or any paragraph of these rules, we are referring to title 17, part 275 of the Code of Federal Regulations [17 CFR 275], in which these rules are published.

[2] *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 194 (1963) (''SEC v. Capital Gains''). *See also infra* notes 26–32 and accompanying text; Investment Adviser Codes of Ethics, Investment Advisers Act Release No. 2256 (July 2, 2004); Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Release No. 2204 (Dec. 17, 2003) (''Compliance Programs Release''); Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV, Investment Advisers Act Release No. 1862 (Apr. 5, 2000). We acknowledge that investment advisers also have antifraud liability with respect to prospective clients under section 206 of the Advisers Act.

[3] *See SEC* v. *Capital Gains, supra* note 2.

[4] An investment adviser has a fiduciary duty to all of its clients, whether or not the client is a retail investor.

[5] Regulation Best Interest, Exchange Act Release No. 34–83062 (April 18, 2018) (''Regulation Best Interest Proposal'').

[6] Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles, Investment Advisers Act Release No. IA–4888 (April 18, 2018) (''Form CRS Proposal'').

[7] This Release is intended to highlight the principles relevant to an adviser's fiduciary duty. It is not, however, intended to be the exclusive resource for understanding these principles.

[8] The Commission recognizes that many advisers provide impersonal investment advice. *See, e.g.,* Advisers Act rule 203A–3 (defining ''impersonal investment advice'' in the context of defining ''investment adviser representative'' as ''investment advisory services provided by means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts''). This Release does not address the extent to which the Advisers Act applies to different types of impersonal investment advice.

dealers under Regulation Best Interest.[9] While we are not proposing a uniform standard of conduct for broker-dealers and investment advisers in light of their different relationship types and models for providing advice, we continue to consider whether we can improve protection of investors through potential enhancements to the legal obligations of investment advisers. Below, in addition to our interpretation of advisers' existing fiduciary obligations, we request comment on three potential enhancements to their legal obligations by considering areas where the current broker-dealer framework provides investor protections that may not have counterparts in the investment adviser context.

II. Investment Advisers' Fiduciary Duty

The Advisers Act establishes a federal fiduciary standard for investment advisers.[10] This fiduciary standard is based on equitable common law principles and is fundamental to advisers' relationships with their clients under the Advisers Act.[11] The fiduciary duty to which advisers are subject is not specifically defined in the Advisers Act or in Commission rules, but reflects a Congressional recognition ''of the delicate fiduciary nature of an investment advisory relationship'' as well as a Congressional intent to ''eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.'' [12] An adviser's fiduciary duty is imposed under the Advisers Act in recognition of the nature of the relationship between an investment adviser and a client and the desire ''so far as is presently practicable to eliminate the abuses'' that led to the enactment of the Advisers Act.[13] It is made enforceable by the antifraud provisions of the Advisers Act.[14]

An investment adviser's fiduciary duty under the Advisers Act comprises a duty of care and a duty of loyalty. Several commenters responding to Chairman Clayton's June 2017 request for public input [15] on the standards of conduct for investment advisers and broker-dealers acknowledged these duties.[16] This fiduciary duty requires an adviser ''to adopt the principal's goals, objectives, or ends.'' [17] This means the adviser must, at all times, serve the best interest of its clients and not subordinate its clients' interest to its own.[18] The federal fiduciary duty is imposed through the antifraud provisions of the Advisers Act.[19] The duty follows the contours of the relationship between the adviser and its client, and the adviser and its client may shape that relationship through contract when the client receives full and fair disclosure and provides informed consent.[20] Although the ability to tailor the terms means that the application of the fiduciary duty will vary with the terms of the relationship, the relationship in all cases remains that of a fiduciary to a client. In other words, the investment adviser cannot disclose or negotiate away, and the investor cannot waive, the federal fiduciary

[9] Regulation Best Interest Proposal, *supra* note 5. In addition to the obligations proposed in Regulation Best Interest, broker-dealers have a variety of existing specific obligations, including, among others, suitability, best execution, and fair and reasonable compensation. *See, e.g., Hanly* v. *SEC,* 415 F.2d 589, 596–97 (2d Cir. 1969) (''A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents that he has an adequate and reasonable basis for the opinions he renders.''); and FINRA rules 2111 (Suitability), 5310 (Best Execution and Interpositioning), and 2121 (Fair Prices and Commissions)).

[10] *Transamerica Mortgage Advisors, Inc.* v. *Lewis,* 444 U.S. 11, 17 (1979) (''Transamerica Mortgage v. Lewis'') (''§ 206 establishes federal fiduciary standards to govern the conduct of investment advisers.'') (quotation marks omitted); *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 471, n.11 (1977) (in discussing *SEC* v. *Capital Gains,* stating that the Supreme Court's reference to fraud in the ''equitable'' sense of the term was ''premised on its recognition that Congress intended the Investment Advisers Act to establish federal fiduciary standards for investment advisers''); *SEC* v. *Capital Gains, supra* note 2; Amendments to Form ADV, Investment Advisers Act Release No. 3060 (July 28, 2010) (''Investment Advisers Act Release 3060'') (''Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own,'' citing Proxy Voting by Investment Advisers, Investment Advisers Act Release No. 2106 (Jan. 31, 2003) (''Investment Advisers Act Release 2106'')).

[11] *See SEC* v. *Capital Gains, supra* note 2 (discussing the history of the Advisers Act, and how equitable principles influenced the common law of fraud and changed the suits brought against a fiduciary, ''which Congress recognized the investment adviser to be'').

[12] *See SEC* v. *Capital Gains, supra* note 2.

[13] *See SEC* v. *Capital Gains, supra* note 2 (''The Advisers Act thus reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship,' as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.'' and also noting that the ''declaration of policy'' in the original bill, which became the Advisers Act, declared that ''the national public interest and the interest of investors are adversely affected when the business of investment advisers is so conducted as to defraud or mislead investors, or to enable such advisers to relieve themselves of their fiduciary obligations to their clients. It [sic] is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is presently practicable to eliminate the abuses enumerated in this section'' (citing S. 3580, 76th Cong., 3d Sess., § 202 and Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong. 2d Sess., 1, at 28). *See also* In the Matter of Arleen W. Hughes, Exchange Act Release No. 4048 (Feb. 18, 1948) (''Arleen Hughes'') (discussing the relationship of trust and confidence between the client and a dual registrant and stating that the registrant was a fiduciary and subject to liability under the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act).

[14] *SEC* v. *Capital Gains, supra* note 2; *Transamerica Mortgage* v. *Lewis, supra* note 10 (''[T]he Act's legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations.'').

[15] Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers, Chairman Jay Clayton (June 1, 2017), *available at https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31* (''Chairman Clayton's Request for Public Input'').

[16] *See, e.g.,* Comment letter of the Investment Adviser Association (Aug. 31, 2017) (''IAA Letter'') (''The well-established fiduciary duty under the Advisers Act, which incorporates both a duty of loyalty and a duty of care, has been applied consistently over the years by courts and the SEC.''); Comment letter of the Consumer Federation of America (Sept. 14, 2017) (''an adviser's fiduciary obligation 'divides neatly into the duty of loyalty and the duty of care.' The duty of loyalty is designed to protect against 'malfeasance,' or wrongdoing, on the part of the adviser, while the duty of care is designed to protect against 'nonfeasance,' such as neglect.'').

[17] Arthur B. Laby, *The Fiduciary Obligations as the Adoption of Ends,* 56 Buffalo Law Review 99 (2008). *See also* Restatement (Third) of Agency, § 2.02 Scope of Actual Authority (2006) (describing a fiduciary's authority in terms of the fiduciary's reasonable understanding of the principal's manifestations and objectives).

[18] Investment Advisers Act Release 3060, *supra* footnote 10 (adopting amendments to Form ADV and stating that ''under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own,'' citing Investment Advisers Act Release 2106 *supra* note 10); *SEC* v. *Tambone,* 550 F.3d 106, 146 (1st Cir. 2008) (''Section 206 imposes a fiduciary duty on investment advisers to act at all times in the best interest of the fund and its investors.''); *SEC* v. *Moran,* 944 F. Supp. 286 (S.D.N.Y 1996) (''Investment advisers are entrusted with the responsibility and duty to act in the best interest of their clients.'').

[19] *See supra* note 14.

[20] *See infra* note 40 and accompanying text for a discussion of informed consent.

duty.[21] We discuss our views[22] on an investment adviser's fiduciary duty in more detail below.[23]

A. Duty of Care

As fiduciaries, investment advisers owe their clients a duty of care.[24] The Commission has discussed the duty of care and its components in a number of contexts.[25] The duty of care includes, among other things: (i) The duty to act and to provide advice that is in the best interest of the client, (ii) the duty to seek best execution of a client's transactions where the adviser has the responsibility to select broker-dealers to execute client trades, and (iii) the duty to provide advice and monitoring over the course of the relationship.

i. Duty To Provide Advice That Is in the Client's Best Interest

We have addressed an adviser's duty of care in the context of the provision of personalized investment advice. In this context, the duty of care includes a duty to make a reasonable inquiry into a client's financial situation, level of financial sophistication, investment experience, and investment objectives (which we refer to collectively as the client's ''investment profile'') and a duty to provide personalized advice that is suitable for and in the best interest of the client based on the client's investment profile.[26]

An adviser must, before providing any personalized investment advice and as appropriate thereafter, make a reasonable inquiry into the client's investment profile. The nature and extent of the inquiry turn on what is reasonable under the circumstances, including the nature and extent of the agreed-upon advisory services, the nature and complexity of the anticipated investment advice, and the investment profile of the client. For example, to formulate a comprehensive financial plan for a client, an adviser might obtain a range of personal and financial information about the client, including current income, investments, assets and debts, marital status, insurance policies, and financial goals.[27]

An adviser must update a client's investment profile in order to adjust its advice to reflect any changed circumstances.[28] The frequency with which the adviser must update the information in order to consider changes to any advice the adviser provides would turn on many factors, including whether the adviser is aware of events that have occurred that could render inaccurate or incomplete the investment profile on which it currently bases its advice. For example, a change in the relevant tax law or knowledge that the client has retired or experienced a change in marital status might trigger an obligation to make a new inquiry.

An investment adviser must also have a reasonable belief that the personalized advice is suitable for and in the best interest of the client based on the client's investment profile. A reasonable belief would involve considering, for example, whether investments are recommended only to those clients who can and are willing to tolerate the risks of those investments and for whom the potential benefits may justify the risks.[29]

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[21] As an adviser's federal fiduciary obligations are enforceable through section 206 of the Act, we would view a waiver of enforcement of section 206 as implicating section 215(a) of the Act, which provides that ''any condition, stipulation or provision binding any person to waive compliance with any provision of this title . . . shall be void.'' Some commenters on Chairman Clayton's Request for Public Input and other Commission requests for comment also stated that an adviser's fiduciary duty could not be disclosed away. *See, e.g.,* IAA Letter *supra* note 16 (''While disclosure of conflicts is crucial, it cannot take the place of the overarching duty of loyalty. In other words, an adviser is still first and foremost bound by its duty to act in its client's best interest and disclosure does not relieve an adviser of this duty.''); Comment letter of AARP (Sept. 6, 2017) (''Disclosure and consent alone do not meet the fiduciary test.''); Financial Planning Coalition Letter (July 5, 2013) responding to SEC Request for Data and Other Information, Duties of Brokers, Dealers, and Investment Advisers, Exchange Act Release No. 69013 (Mar. 1, 2013) (''Financial Planning Coalition 2013 Letter'') (''[D]isclosure alone is not sufficient to discharge an investment adviser's fiduciary duty; rather, the key issue is whether the transaction is in the best interest of the client.'') (internal citations omitted). *See also* Restatement (Third) of Agency, § 8.06 Principal's Consent (2006) (''The law applicable to relationships of agency as defined in § 1.01 imposes mandatory limits on the circumstances under which an agent may be empowered to take disloyal action. These limits serve protective and cautionary purposes. Thus, an agreement that contains general or broad language purporting to release an agent in advance from the agent's general fiduciary obligation to the principal is not likely to be enforceable. This is because a broadly sweeping release of an agent's fiduciary duty may not reflect an adequately informed judgment on the part of the principal; if effective, the release would expose the principal to the risk that the agent will exploit the agent's position in ways not foreseeable by the principal at the time the principal agreed to the release. In contrast, when a principal consents to specific transactions or to specified types of conduct by the agent, the principal has a focused opportunity to assess risks that are more readily identifiable.''); Tamar Frankel, Arthur Laby & Ann Schwing, *The Regulation of Money Managers,* (updated 2017) (''The Regulation of Money Managers'') (''Disclosure may, but will not always, cure the fraud, since a fiduciary owes a duty to deal fairly with clients.'').

[22] In various circumstances, other regulators, including the U.S. Department of Labor, and other legal regimes, including state securities law, impose obligations on investment advisers. In some cases, these standards may differ from the standard imposed and enforced by the Commission.

[23] The interpretations discussed in this Release also apply to automated advisers, which are often colloquially referred to as ''robo-advisers.'' Robo-advisers, like all SEC-registered investment advisers, are subject to all of the requirements of the Advisers Act, including the requirement that they provide advice consistent with the fiduciary duty they owe to their clients. The staff of the Commission has issued guidance regarding how robo-advisers can meet their obligations under the Advisers Act, given the unique challenges and opportunities presented by their business models. *See Division of Investment Management, SEC, Staff Guidance on Robo Advisers,* (February 2017), *available at https://www.sec.gov/investment/im-guidance-2017-02.pdf.*

[24] *See* Investment Advisers Act Release No. 2106, *supra* note 10 (stating that under the Advisers Act, ''an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting,'' which is the subject of the release, and citing *SEC* v. *Capital Gains supra* note 2, to support this point). *See also* Restatement (Third) of Agency, § 8.08 (discussing the duty of care that an agent owes its principal as a matter of common law); The Regulation of Money Managers, *supra* note 21 (''Advice can be divided into three stages. The first determines the needs of the particular client. The second determines the portfolio strategy that would lead to meeting the client's needs. The third relates to the choice of securities that the portfolio would contain. The duty of care relates to each of the stages and depends on the depth or extent of the advisers' obligation towards their clients.'').

[25] *See, e.g.,* Suitability of Investment Advice Provided by Investment Advisers; Custodial Account Statements for Certain Advisory Clients, Investment Advisers Act Release No. 1406 (Mar. 16, 1994) (''Investment Advisers Act Release 1406'') (stating that advisers have a duty of care and discussing advisers' suitability obligations); Securities; Brokerage and Research Services, Exchange Act Release No. 23170 (Apr. 23, 1986) (''Exchange Act Release 23170'') (''an adviser, as a fiduciary, owes its clients a duty of obtaining the best execution on securities transactions.''). We highlight certain contexts in which the Commission has addressed the duty of care but we note that there are others; for example, voting proxies when an adviser undertakes to do so. Investment Advisers Act Release 2106, *supra* note 10.

[26] In 1994, the Commission proposed a rule that would make express the fiduciary obligation of investment advisers to make only suitable recommendations to a client. Investment Advisers Act Release 1406, *supra* note 25. Although never adopted, the rule was designed, among other things, to reflect the Commission's interpretation of an adviser's existing suitability obligation under the Advisers Act. We believe that this obligation, when combined with an adviser's fiduciary duty to act in the best interest of its client, requires an adviser to provide investment advice that is suitable for *and in the best interest of* its client.

[27] Investment Advisers Act Release 1406, *supra* note 25. After making a reasonable inquiry into the client's investment profile, it generally would be reasonable for an adviser to rely on information provided by the client (or the client's agent) regarding the client's financial circumstances, and an adviser should not be held to have given advice not in its client's best interest if it is later shown that the client had misled the adviser.

[28] We note that this would not be done for a one-time financial plan or other investment advice that is not provided on an ongoing basis. *See also infra* note 37.

[29] We note that Item 8 of Part 2A of Form ADV requires an investment adviser to describe its methods of analysis and investment strategies and disclose that investing in securities involves risk of loss which clients should be prepared to bear. This

Whether the advice is in a client's best interest must be evaluated in the context of the portfolio that the adviser manages for the client and the client's investment profile. For example, when an adviser is advising a client with a conservative investment objective, investing in certain derivatives may be in the client's best interest when they are used to hedge interest rate risk in the client's portfolio, whereas investing in certain directionally speculative derivatives on their own may not. For that same client, investing in a particular security on margin may not be in the client's best interest, even if investing in that same security may be in the client's best interest. When advising a financially sophisticated investor with a high risk tolerance, however, it may be consistent with the adviser's duties to recommend investing in such directionally speculative derivatives or investing in securities on margin.

The cost (including fees and compensation) associated with investment advice would generally be one of many important factors—such as the investment product's or strategy's investment objectives, characteristics (including any special or unusual features), liquidity, risks and potential benefits, volatility and likely performance in a variety of market and economic conditions—to consider when determining whether a security or investment strategy involving a security or securities is in the best interest of the client. Accordingly, the fiduciary duty does not necessarily require an adviser to recommend the lowest cost investment product or strategy. We believe that an adviser could not reasonably believe that a recommended security is in the best interest of a client if it is higher cost than a security that is otherwise identical, including any special or unusual features, liquidity, risks and potential benefits, volatility and likely performance. For example, if an adviser advises its clients to invest in a mutual fund share class that is more expensive than other available options when the adviser is receiving compensation that creates a potential conflict and that may reduce the client's return, the adviser may violate its fiduciary duty and the antifraud provisions of the Advisers Act if it does not, at a minimum, provide full and fair disclosure of the conflict and its impact on the client and obtain informed client consent to the conflict.[30] Furthermore, an adviser would not satisfy its fiduciary duty to provide advice that is in the client's best interest by simply advising its client to invest in the least expensive or least remunerative investment product or strategy without any further analysis of other factors in the context of the portfolio that the adviser manages for the client and the client's investment profile. For example, it might be consistent with an adviser's fiduciary duty to advise a client with a high risk tolerance and significant investment experience to invest in a private equity fund with relatively high fees if other factors about the fund, such as its diversification and potential performance benefits, cause it to be in the client's best interest. We believe that a reasonable belief that investment advice is in the best interest of a client also requires that an adviser conduct a reasonable investigation into the investment sufficient to not base its advice on materially inaccurate or incomplete information.[31] We have brought enforcement actions where an investment adviser did not independently or reasonably investigate securities before recommending them to clients.[32] This obligation to provide advice that is suitable and in the best interest applies not just to potential investments, but to all advice the investment adviser provides to clients, including advice about an investment strategy or engaging a sub-adviser and advice about whether to rollover a retirement account so that the investment adviser manages that account.

ii. Duty To Seek Best Execution

We have addressed an investment adviser's duty of care in the context of trade execution where the adviser has the responsibility to select broker-dealers to execute client trades (typically in the case of discretionary accounts). We have said that, in this context, an adviser has the duty to seek best execution of a client's transactions.[33] In meeting this obligation, an adviser must seek to obtain the execution of transactions for each of its clients such that the client's total cost or proceeds in each transaction are the most favorable under the circumstances. An adviser fulfills this duty by executing securities transactions on behalf of a client with the goal of maximizing value for the client under the particular circumstances occurring at the time of the transaction. As noted below, maximizing value can encompass more than just minimizing cost. When seeking best execution, an adviser should consider ''the full range and quality of a broker's services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness'' to the adviser.[34] In other words, the determinative factor is not the lowest possible commission cost but whether the transaction represents the best qualitative execution. Further, an investment adviser should ''periodically and systematically'' evaluate the execution it is receiving for clients.[35]

iii. Duty To Act and To Provide Advice and Monitoring Over the Course of the Relationship

An investment adviser's duty of care also encompasses the duty to provide advice and monitoring over the course of a relationship with a client.[36] An

item also requires that an adviser explain the material risks involved for each significant investment strategy or method of analysis it uses and particular type of security it recommends, with more detail if those risks are significant or unusual.

[30] *See infra* notes 48–52 and accompanying text (discussing an adviser's duties related to disclosure and consent).

[31] *See, e.g.,* Concept Release on the U.S. Proxy System, Investment Advisers Act Release No. 3052 (July 14, 2010) (stating ''as a fiduciary, the proxy advisory firm has a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information'').

[32] *See* In the Matter of Larry C. Grossman, Investment Advisers Act Release No. 4543 (Sept. 30, 2016) (Commission opinion) (imposing liability on a principal of a registered investment adviser for recommending offshore private investment funds to clients without a reasonable independent basis for his advice).

[33] *See* Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 54165 (July 18, 2006) (stating that investment advisers have ''best execution obligations''); Investment Advisers Act Release 3060, *supra* note 10 (discussing an adviser's best execution obligations in the context of directed brokerage arrangements and disclosure of soft dollar practices). *See also* Advisers Act rule 206(3)–2(c) (referring to adviser's duty of best execution of client transactions).

[34] Exchange Act Release 23170, *supra* note 25.

[35] *Id.* The Advisers Act does not prohibit advisers from using an affiliated broker to execute client trades. However, the adviser's use of such an affiliate involves a conflict of interest that must be fully and fairly disclosed and the client must provide informed consent to the conflict.

[36] *See SEC* v. *Capital Gains, supra* note 2 (describing advisers' ''basic function'' as ''furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments'' (quoting Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong. 2d Sess., 1, at 28)). *Cf.* Barbara Black, *Brokers and Advisers-What's in a Name?,* 32 Fordham Journal of Corporate and Financial Law XI (2005) (''[W]here

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adviser is required to provide advice and services to a client over the course of the relationship at a frequency that is both in the best interest of the client and consistent with the scope of advisory services agreed upon between the investment adviser and the client. The duty to provide advice and monitoring is particularly important for an adviser that has an ongoing relationship with a client (for example, a relationship where the adviser is compensated with a periodic asset-based fee or an adviser with discretionary authority over client assets). Conversely, the steps needed to fulfill this duty may be relatively circumscribed for the adviser and client that have agreed to a relationship of limited duration via contract (for example, a financial planning relationship where the adviser is compensated with a fixed, one-time fee commensurate with the discrete, limited-duration nature of the advice provided).[37] An adviser's duty to monitor extends to all personalized advice it provides the client, including an evaluation of whether a client's account or program type (for example, a wrap account) continues to be in the client's best interest.

B. Duty of Loyalty

The duty of loyalty requires an investment adviser to put its client's interests first. An investment adviser must not favor its own interests over those of a client or unfairly favor one client over another.[38] In seeking to meet its duty of loyalty, an adviser must make full and fair disclosure to its clients of all material facts relating to the advisory relationship.[39] In addition, an adviser must seek to avoid conflicts of interest with its clients, and, at a minimum, make full and fair disclosure of all material conflicts of interest that could affect the advisory relationship. The disclosure should be sufficiently specific so that a client is able to decide whether to provide informed consent to the conflict of interest.[40] We discuss each of these aspects of the duty of loyalty below.

Because an adviser must serve the best interests of its clients, it has an obligation not to subordinate its clients' interests to its own. For example, an adviser cannot favor its own interests over those of a client, whether by favoring its own accounts or by favoring certain client accounts that pay higher fee rates to the adviser over other client accounts.[41] Accordingly, the duty of loyalty includes a duty not to treat some clients favorably at the expense of other clients. Thus, we believe that in allocating investment opportunities among eligible clients, an adviser must treat all clients fairly.[42] This does not mean that an adviser must have a *pro rata* allocation policy, that the adviser's allocation policies cannot reflect the differences in clients' objectives or investment profiles, or that the adviser cannot exercise judgment in allocating eligible investment opportunities among eligible clients. Rather, it means that an adviser's allocation policies must be fair and, if they present a conflict, the adviser must fully and fairly disclose the conflict such that a client can provide informed consent.

An adviser must seek to avoid conflicts of interest with its clients, and, at a minimum, make full and fair disclosure to its clients of all material conflicts of interest that could affect the advisory relationship.[43] Disclosure of a conflict alone is not always sufficient to satisfy the adviser's duty of loyalty and section 206 of the Advisers Act.[44] Any

the investment adviser's duties include management of the account, [the adviser] is under an obligation to monitor the performance of the account and to make appropriate changes in the portfolio.''); Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers,* 55 Villanova Law Review 701, at 728 (2010) (''Laby Villanova Article'') (''If an adviser has agreed to provide continuous supervisory services, the scope of the adviser's fiduciary duty entails a continuous, ongoing duty to supervise the client's account, regardless of whether any trading occurs. This feature of the adviser's duty, even in a non-discretionary account, contrasts sharply with the duty of a broker administering a non-discretionary account, where no duty to monitor is required.'') (internal citations omitted).

[37] *See* Laby Villanova Article, *supra* note 36, at 728 (2010) (stating that the scope of an adviser's activity can be altered by contract and that an adviser's fiduciary duty would be commensurate with the scope of the relationship).

[38] *See* Investment Advisers Act Release 3060 (''Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subrogate clients' interests to its own,'' citing Investment Advisers Act Release 2106 *supra* note 9). *See also* Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011), *available at https://www.sec.gov/news/studies/2011/913studyfinal.pdf* (''913 Study'').

[39] Investment Advisers Act Release 3060, *supra* note 6 (''as a fiduciary, an adviser has an ongoing obligation to inform its clients of any material information that could affect the advisory relationship''). *See also* General Instruction 3 to Part 2 of Form ADV (''Under federal and state law, you are a fiduciary and must make full disclosure to your *clients* of all material facts relating to the advisory relationship.'').

[40] Arleen Hughes, *supra* note 13, at 4 and 8 (stating, ''[s]ince loyalty to his trust is the first duty which a fiduciary owes to his principal, it is the general rule that a fiduciary must not put himself into a position where his own interests may come in conflict with those of his principal. To prevent any conflict and the possible subordination of this duty to act solely for the benefit of his principal, a fiduciary at common law is forbidden to deal as an adverse party with his principal. An exception is made, however, where the principal gives his informed consent to such dealings,'' and adding that, ''[r]egistrant has an affirmative obligation to disclose all material facts to her clients in a manner which is clear enough so that a client is fully apprised of the facts and is in a position to give his informed consent.''). *See also Hughes* v. *Securities and Exchange Commission,* 174 F.2d 969 (1949) (affirming the SEC decision in Arleen Hughes).

See also General Instruction 3 to Part 2 of Form ADV (stating that an adviser's disclosure obligation ''requires that [the adviser] provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest [the adviser has] and the business practices in which [the adviser] engage[s], and can give informed consent to such conflicts or practices or reject them''); Investment Advisers Act Release 3060, *supra* note 10 (same); Restatement (Third) of Agency § 8.06 (''Conduct by an agent that would otherwise constitute a breach of duty as stated in §§ 8.01, 8.02, 8.03, 8.04, and 8.05 [referencing the fiduciary duty] does not constitute a breach of duty if the principal consents to the conduct, provided that (a) in obtaining the principal's consent, the agent (i) acts in good faith, (ii) discloses all material facts that the agent knows, has reason to know, or should know would reasonably affect the principal's judgment unless the principal has manifested that such facts are already known by the principal or that the principal does not wish to know them, and (iii) otherwise deals fairly with the principal; and (b) the principal's consent concerns either a specific act or transaction, or acts or transactions of a specified type that could reasonably be expected to occur in the ordinary course of the agency relationship'').

[41] The Commission has brought numerous enforcement actions against advisers that unfairly allocated trades to their own accounts and allocated less favorable or unprofitable trades to their clients' accounts. *See, e.g., SEC* v. *Strategic Capital Management, LLC and Michael J. Breton,* Litigation Release No. 23867 (June 23, 2017) (partial settlement) (adviser placed trades through a master brokerage account and then allocated profitable trades to adviser's account while placing unprofitable trades into the client accounts.).

[42] *See also* Barry Barbash and Jai Massari, *The Investment Advisers Act of 1940; Regulation by Accretion,* 39 Rutgers Law Journal 627 (2008) (stating that under section 206 of the Advisers Act and traditional notions of fiduciary and agency law an adviser must not give preferential treatment to some clients or systematically exclude eligible clients from participating in specific opportunities without providing the clients with appropriate disclosure regarding the treatment).

[43] *See SEC* v. *Capital Gains, supra* note 2 (advisers must fully disclose all material conflicts, citing Congressional intent ''to eliminate, or at least expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested''). *See also* Investment Advisers Act Release 3060, *supra* note 9.

[44] *See SEC* v. *Capital Gains, supra* note 2 (in discussing the legislative history of the Advisers Act, citing ethical standards of one of the leading investment counsel associations, which provided that an investment counsel should remain ''as free as humanly possible from the subtle influence of prejudice, conscious or unconscious'' and ''avoid any affiliation, or any act which subjects his position to challenge in this respect'' and stating that one of the policy purposes of the Advisers Act is ''to mitigate and, so far as is presently practicable to eliminate the abuses'' that formed the basis of the Advisers Act). Separate and apart from potential liability under the antifraud provisions of the Advisers Act enforceable by the Commission for breaches of fiduciary duty in the absence of full and fair disclosure, investment advisers may also wish to consider their potential liability to clients under

disclosure must be clear and detailed enough for a client to make a reasonably informed decision to consent to such conflicts and practices or reject them.[45] An adviser must provide the client with sufficiently specific facts so that the client is able to understand the adviser's conflicts of interest and business practices well enough to make an informed decision.[46] For example, an adviser disclosing that it "may" have a conflict is not adequate disclosure when the conflict actually exists.[47] A client's informed consent can be either explicit or, depending on the facts and circumstances, implicit. We believe, however, that it would not be consistent with an adviser's fiduciary duty to infer or accept client consent to a conflict where either (i) the facts and circumstances indicate that the client did not understand the nature and import of the conflict, or (ii) the material facts concerning the conflict could not be fully and fairly disclosed.[48] For example, in some cases, conflicts may be of a nature and extent that it would be difficult to provide disclosure that adequately conveys the material facts or the nature, magnitude and potential effect of the conflict necessary to obtain informed consent and satisfy an adviser's fiduciary duty. In other cases, disclosure may not be specific enough for clients to understand whether and how the conflict will affect the advice they receive. With some complex or extensive conflicts, it may be difficult to provide disclosure that is sufficiently specific, but also understandable, to the adviser's clients. In all of these cases where full and fair disclosure and informed consent is insufficient, we expect an adviser to eliminate the conflict or adequately mitigate the conflict so that it can be more readily disclosed.

Full and fair disclosure of all material facts that could affect an advisory relationship, including all material conflicts of interest between the adviser and the client, can help clients and prospective clients in evaluating and selecting investment advisers. Accordingly, we require advisers to deliver to their clients a "brochure," under Part 2A of Form ADV, which sets out minimum disclosure requirements, including disclosure of certain conflicts.[49] Investment advisers are required to deliver the brochure to a prospective client at or before entering into a contract so that the prospective client can use the information contained in the brochure to decide whether or not to enter into the advisory relationship.[50] In a concurrent release, we are proposing to require all investment advisers to deliver to retail investors before or at the time the adviser enters into an investment advisory agreement a relationship summary which would include a summary of certain conflicts of interest.[51]

C. Request for Comment

The Commission requests comment on our proposed interpretation regarding certain aspects of the fiduciary duty under section 206 of the Advisers Act.

- Does the Commission's proposed interpretation offer sufficient guidance with respect to the fiduciary duty under section 206 of the Advisers Act?
- Are there any significant issues related to an adviser's fiduciary duty that the proposed interpretation has not addressed?
- Would it be beneficial for investors, advisers or broker-dealers for the Commission to codify any portion of our proposed interpretation of the fiduciary duty under section 206 of the Advisers Act?

III. Economic Considerations

The Commission is sensitive to the potential economic effects of the proposed interpretation provided above.[52] In this section we discuss how the proposed Commission interpretation may benefit investors and reduce agency problems by reaffirming and clarifying the fiduciary duty an investment adviser owes to its clients. We also discuss some potential broader economic effects on the market for investment advice.

A. Background

The Commission's interpretation of the standard of conduct for investment advisers under the Advisers Act set forth in this Release would affect investment advisers and their associated persons as well as the clients of those investment advisers, and the market for financial advice more broadly.[53] There are 12,659 investment advisers registered with the Commission with over $72 trillion in assets under management as well as 17,635 investment advisers registered with states and 3,587 investment advisers who submit Form ADV as exempt reporting advisers.[54] As of December

state common law, which may vary from state to state.

[45] *See* Arlene Hughes, *supra* at 13 (in finding that registrant had not obtained informed consent, citing to testimony indicating that "some clients had no understanding at all of the nature and significance" of the disclosure).

[46] *See* General Instruction 3 to Part 2 of Form ADV. *Cf.* Arleen Hughes, *supra* note 13 (Hughes acted simultaneously in the dual capacity of investment adviser and of broker and dealer and conceded having a fiduciary duty. In describing the fiduciary duty and her potential liability under the antifraud provisions of the Securities Act and the Exchange Act, the Commission stated she had "an affirmative obligation to disclose all material facts to her clients in a manner which is clear enough so that a client is fully apprised of the facts and is in a position to give his informed consent.").

[47] We have brought enforcement actions in such cases. *See, e.g.,* In the Matter of The Robare Group, Ltd., et al., Investment Advisers Act Release No. 4566 (Nov. 7, 2016) (Commission Opinion) (appeal docketed) (finding, among other things, that adviser's disclosure was inadequate because it stated that the adviser *may* receive compensation from a broker as a result of the facilitation of transactions on client's behalf through such broker-dealer and that these arrangements *may* create a conflict of interest when adviser *was,* in fact, receiving payments from the broker and *had* such a conflict of interest).

[48] *See* Arleen Hughes, *supra* note 13 ("Registrant cannot satisfy this duty by executing an agreement with her clients which the record shows some clients do not understand and which, in any event, does not contain the essential facts which she must communicate.") Some commenters on Commission requests for comment agreed that full and fair disclosure and informed consent are important components of an adviser's fiduciary duty. *See, e.g.,* Financial Planning Coalition 2013 Letter, *supra* note 21 ("[C]onsent is only informed if the customer has the ability fully to understand and to evaluate the information. Many complex products . . . are appropriate only for sophisticated and experienced investors. It is not sufficient for a fiduciary to make disclosure of potential conflicts of interest with respect to such products. The fiduciary must make a reasonable judgment that the customer is fully able to understand and to evaluate the product and the potential conflicts of interest that it presents—and then the fiduciary must make a judgment that the product is in the best interests of the customer.").

[49] Investment Advisers Act Release 3060, *supra* note 10; General Instruction 3 to Part 2 of Form ADV ("Under federal and state law, you are a fiduciary and must make full disclosure to your clients of all material facts relating to the advisory relationship. As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and, at a minimum, make full disclosure of all material conflicts of interest between you and your clients that could affect the advisory relationship. This obligation requires that you provide the client with sufficiently specific facts so that the client is able to understand the conflicts of interest you have and the business practices in which you engage, and can give informed consent to such conflicts or practices or reject them.").

[50] Investment Advisers Act rule 204–3. Investment Advisers Act Release 3060, *supra* note 10 (adopting amendments to Form ADV and stating that "A client may use this disclosure to select his or her own adviser and evaluate the adviser's business practices and conflicts on an ongoing basis. As a result, the disclosure clients and prospective clients receive is critical to their ability to make an informed decision about whether to engage an adviser and, having engaged the adviser, to manage that relationship.").

[51] Form CRS Proposal, *supra* note 6.

[52] The Commission, where possible, has sought to quantify the economic impacts expected to result from the proposed interpretations. However, as discussed more specifically below, the Commission is unable to quantify certain of the economic effects because it lacks information necessary to provide reasonable estimates.

[53] *See* Form CRS Proposal, *supra* note 6, at Section IV.A (discussing the market for financial advice generally).

[54] *See* Form CRS Proposal, *supra* note 6, at Section IV.A.1.b (discussing SEC-registered

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2017, there are approximately 36 million client accounts advised by SEC-registered investment advisers.

These investment advisers currently incur ongoing costs related to their compliance with their legal and regulatory obligations, including costs related to their understanding of the standard of conduct. We believe, based on the Commission's experience, that the interpretations we are setting forth in this Release are generally consistent with investment advisers' current understanding of the practices necessary to comply with their fiduciary duty under the Advisers Act; however, we recognize that there may be certain current investment advisers who have interpreted their fiduciary duty to require something less, or something more, than the Commission's interpretation. We lack data to identify which investment advisers currently understand the practices necessary to comply with their fiduciary duty to be different from the standard of conduct in the Commission's interpretation. Based on our experience, however, we generally believe that it is not a significant portion of the market.

B. Economic Impacts

Based on our experience as the long-standing regulator of the investment adviser industry, the Commission's interpretation of the fiduciary duty under section 206 of the Advisers Act described in this Release generally reaffirms the current practices of investment advisers. Therefore, we expect there to be no significant economic impacts from the interpretation. We do acknowledge, however, to the extent certain investment advisers currently understand the practices necessary to comply with their fiduciary duty to be different from those discussed in this interpretation, there could be some potential economic effects, which we discuss below.

Clients of Investment Advisers

The typical relationship between an investment adviser and a client is a principal-agent relationship, where the principal (the client) hires an agent (the investment adviser) to perform some service (investment advisory services) on the client's behalf.[55] Because investors and investment advisers are likely to have different preferences and goals, the investment adviser relationship is subject to agency problems: That is, investment advisers may take actions that increase their well-being at the expense of investors, thereby imposing agency costs on investors.[56] A fiduciary duty, such as the duty investment advisers owe their clients, can mitigate these agency problems and reduce agency costs by deterring agents from taking actions that expose them to legal liability.[57]

To the extent the Commission's interpretation of investment adviser fiduciary duty would cause a change in behavior of those investment advisers, if any, who currently interpret their fiduciary duty to require something different from the Commission's interpretation, we expect a potential reduction in agency problems and, consequently, a reduction of agency costs to the client. The extent to which agency costs would be reduced is difficult to assess given that we are unable to ascertain whether any investment advisers currently interpret their fiduciary duty to be something different from the Commission's interpretation, and consequently we are not able to estimate the agency costs these advisers, if any, currently impose on investors. However, we believe that there may be potential benefits for clients of those investment advisers, if any, to the extent the Commission's interpretation is effective at strengthening investment advisers' understanding of their obligations to their clients. For example, to the extent that the Commission's interpretation enhances the understanding of any investment advisers of their duty of care, it may potentially raise the quality of investment advice given and that advice's fit with a client's individual profile and preferences or lead to increased compliance with the duty to provide advice and monitoring over the course of the relationship.

Additionally, to the extent the Commission's interpretation enhances the understanding of any investment advisers of their duty of loyalty it may potentially benefit the clients of those investment advisers. Specifically, to the extent this leads to a higher quality of disclosures about conflicts for clients of some investment advisers, the nature and extent of such conflict disclosures would help investors better assess the quality of the investment advice they receive, therefore providing an important benefit to investors.

Further, to the extent that the interpretation causes some investment advisers to properly identify circumstances in which disclosure alone cannot cure a conflict of interest, the proposed interpretation may lead those investment advisers to take additional steps to mitigate or eliminate the conflict. The interpretation may also cause some investment advisers to conclude in some circumstances that even if disclosure would be enough to meet their fiduciary duty, such disclosure would have to be so expansive or complex that they instead voluntarily mitigate or eliminate the conflicts of interest. Thus, to the extent the Commission's interpretation would cause investment advisers to better understand their obligations as part of their fiduciary duty and therefore to make changes to their business practices in ways that reduce the likelihood of conflicted advice or the magnitude of the conflicts, it may ameliorate the agency conflict between investment advisers and their clients and, in turn, may improve the quality of advice that the clients receive. This less-conflicted advice may therefore produce higher overall returns for clients and increase the efficiency of portfolio allocation. However, as discussed above, we would generally expect these effects to be minimal. Finally, this interpretation would also benefit clients of investment advisers to the extent it assists the Commission in its oversight of investment advisers' compliance with their regulatory obligations.

Investment Advisers and the Market for Investment Advice

In general, we expect the Commission's interpretation of an investment adviser's fiduciary duty would affirm investment advisers' understanding of the obligations they owe their clients, reduce uncertainty for advisers, and facilitate their compliance. Furthermore, by addressing in one release certain aspects of the fiduciary duty that an investment adviser owes to its clients, the Commission's interpretation could reduce the costs associated with comprehensively assessing their compliance obligations. We acknowledge that, as with other

investment advisers). Note, however, that because we are interpreting advisers' fiduciary duties under section 206 of the Advisers Act, this interpretation would be applicable to both SEC- and state-registered investment advisers, as well as other investment advisers that are exempt from registration or subject to a prohibition on registration under the Advisers Act.

[55] *See, e.g.,* James A. Brickley, Clifford W. Smith, Jr., Jerold L. Zimmerman, *Managerial Economics and Organizational Architecture* (2004), at 265 (''An agency relationship consists of an agreement under which one party, the principal, engages another party, the agent, to perform some service on the principal's behalf.''). *See also* Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,* Journal of Financial Economics, Vol. 3, 305–360 (1976).

[56] *See, e.g.,* Jensen and Meckling, *supra* note 55. *See also* the discussion on agency problems in the market for investment advice in Section IV.B. of the Regulation Best Interest Proposal, *supra* note 5.

[57] *See, e.g.,* Frank H. Easterbrook and Daniel R. Fischel, *Contract and Fiduciary Duty,* Journal of Law & Economics, Vol. 36, 425–46 (1993).

circumstances in which the Commission speaks to the legal obligations of regulated entities, affected firms, including those whose practices are consistent with the Commission's interpretation, incur costs to evaluate the Commission's interpretation and assess its applicability to them. Moreover, as discussed above, there may be certain investment advisers who currently understand the practices necessary to comply with their fiduciary duty to be different from the standard of conduct in the Commission's interpretation. Those investment advisers if any, would experience an increase in their compliance costs as they change their systems, processes and behavior, and train their supervised persons, to align with the Commission's interpretation.

Moreover, to the extent any investment advisers that understood their fiduciary obligation to be different from the Commission's interpretation change their behavior to align with this interpretation, there could potentially also be some economic effects on the market for investment advice. For example, any improved compliance may not only reduce agency costs in current investment advisory relationships and increase the value of those relationships to current clients, it may also increase trust in the market for investment advice among all investors, which may result in more investors seeking advice from investment advisers. This may, in turn, benefit investors by improving the efficiency of their portfolio allocation. To the extent it is costly or difficult, at least in the short term, to expand the supply of investment advisory services to meet an increase in demand, any such new demand for investment adviser services could potentially put some upward price pressure on fees. At the same time, however, if any such new demand increases the overall profitability of investment advisory services, then we expect it would encourage entry by new investment advisers—or hiring of new representatives, by current investment advisers—such that competition would increase over time. Indeed, we recognize that the recent growth in the investment adviser segment of the market, both in terms of firms and number of representatives,[58] may suggest that the costs of expanding the supply of investment advisory services are currently relatively low.

Additionally, we acknowledge that to the extent certain investment advisers recognize, due to the Commission's interpretation, that their obligations to clients are stricter than how they currently interpret their fiduciary duty, it could potentially affect competition. Specifically, the Commission's interpretation of certain aspects of the standard of conduct for investment advisers may result in additional compliance costs to meet their fiduciary obligation under the Commission's interpretation. This increase in compliance costs, in turn, may discourage competition for client segments that generate lower revenues, such as clients with relatively low levels of financial assets, which could reduce the supply of investment adviser services and raise fees for these client segments. However, the investment advisers who already are complying with the understanding of their fiduciary duty reflected in the Commission's interpretation, and may therefore currently have a comparative cost disadvantage, could potentially find it more profitable to compete for the customers of those investment advisers who would face higher compliance costs as a result of the proposed interpretation, which would mitigate negative effects on the supply of investment adviser services. Furthermore, as noted above, there has been a recent growth trend in the supply of investment advisory services, which is likely to mitigate any potential negative supply effects from the Commission's interpretation.[59]

Finally, to the extent the proposed interpretation would cause some investment advisers to reassess their compliance with their disclosure obligations, it could lead to a reduction in the expected profitability of certain products associated with particularly conflicted advice for which compliance costs would increase following the reassessment.[60] As a result, the number of investment advisers willing to advise a client to make these investments may be reduced. A decline in the supply of investment adviser advice on these investments could potentially reduce the efficiency of portfolio allocation of those investors who might otherwise benefit from investment adviser advice on these investments.

IV. Request for Comment Regarding Areas of Enhanced Investment Adviser Regulation

In 2011, the Commission issued the staff's 913 Study, pursuant to section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, in which the staff recognized several areas for potential harmonization of broker-dealer and investment adviser regulation.[61] We have identified a few discrete areas where the current broker-dealer framework provides investor protections that may not have counterparts in the investment adviser context, and request comment on those areas. The Commission intends to consider these comments in connection with any future proposed rules or other proposed regulatory actions with respect to these matters.

A. Federal Licensing and Continuing Education

Associated persons of broker-dealers that effect securities transactions are required to be registered with the Financial Industry Regulatory Authority (''FINRA''),[62] and must meet

[58] *See* Form CRS Proposal, *supra* note 6, at Section IV.A.1.d.

[59] Beyond having an effect on competition in the market for investment adviser services, it is possible that the Commission's interpretation could affect competition between investment advisers and other providers of financial advice, such as broker-dealers, banks, and insurance companies. This may be the case if certain investors base their choice between an investment adviser and another provider of financial advice, at least in part, on their perception of the standards of conduct each owes to their customers. To the extent that the Commission's interpretation increases investors' trust in investment advisers' overall compliance with their standard of conduct, certain of these investors may become more willing, to hire an investment adviser rather than one of their non-investment adviser competitors. As a result, investment advisers as a group may increase their competitive situation compared to that of other types of providers of financial advice. On the other hand, if the Commission's interpretation raises costs for investment advisers, they could become less competitive with other financial services providers.

[60] For example, such products could include highly complex, high cost products with risk and return characteristics that are hard to fully understand for retail investors or mutual funds or fund share classes that may pay higher compensation to investment advisers that are dual registrants, or that the investment adviser and its representatives may receive through payments to an affiliated broker-dealer or third party broker-dealer with which representatives of the investment adviser are associated.

[61] The staff made two primary recommendations in the 913 Study. The first recommendation was that we engage in rulemaking to implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. The second recommendation was that we consider harmonizing certain regulatory requirements of broker-dealers and investment advisers where such harmonization appears likely to enhance meaningful investor protection, taking into account the best elements of each regime. In the 913 Study, the areas the staff suggested the Commission consider for harmonization included, among others, licensing and continuing education requirements for persons associated with firms. The staff stated that the areas identified were not intended to be a comprehensive or exclusive listing of potential areas of harmonization. *See* 913 Study *supra* note 38.

[62] Generally, all registered broker-dealers that deal with the public must become members of

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qualification requirements, which include passing a securities qualification exam and fulfilling continuing education requirements.[63] The federal securities laws do not require investment adviser representatives to become licensed or to meet qualification requirements, but most states impose registration, licensing, or qualification requirements on investment adviser representatives who have a place of business in the state, regardless of whether the investment adviser is registered with the Commission or the state.[64] These qualification requirements typically mandate that investment adviser representatives register and pass certain securities exams or hold certain designations (such as Chartered Financial Analyst credential).[65] The staff recommended in the 913 Study that the Commission consider requiring investment adviser representatives to be subject to federal continuing education and licensing requirements.[66]

We request comment on whether there should be federal licensing and continuing education requirements for personnel of SEC-registered investment advisers. Such requirements could be designed to address minimum and ongoing competency requirements for the personnel of SEC-registered advisers.[67]

- Should investment adviser representatives be subject to federal continuing education and licensing requirements?
- Which advisory personnel should be included in these requirements? For example, should persons whose functions are solely clerical or ministerial be excluded, similar to the exclusion in the FINRA rules regarding broker-dealer registered representatives? Should a subset of registered investment adviser personnel (such as supervised persons, individuals for whom an adviser must deliver a Form ADV brochure supplement, ''investment adviser representatives'' as defined in the Advisers Act, or some other group) be required to comply with such requirements?
- How should the continuing education requirement be structured? How frequent should the certification be? How many hours of education should be required? Who should determine what qualifies as an authorized continuing education class?
- How could unnecessary duplication of any existing continuing education requirement be avoided?
- Should these individuals be required to register with the Commission? What information should these individuals be required to disclose on any registration form? Should the registration requirements mirror the requirements of existing Form U4 or require additional information? Should such registration requirements apply to individuals who provide advice on behalf of SEC-registered investment advisers but fall outside the definition of ''investment adviser representative'' in rule 203A–3 (because, for example, they have five or fewer clients who are natural persons, they provide impersonal investment advice, or ten percent or less of their clients are individuals other than qualified clients)? Should these individuals be required to pass examinations, such as the Series 65 exam required by most states, or to hold certain designations, as part of any registration requirements? Should other steps be required as well, such as a background check or fingerprinting? Would a competency or other examination be a meritorious basis upon which to determine competency and proficiency? Would a competency or other examination requirement provide a false sense of security to advisory clients of competency or proficiency?
- If continuing education requirements are a part of any licensing requirements, should specific topics or types of training be required? For example, these individuals could be required to complete a certain amount of training dedicated to ethics, regulatory requirements or the firm's compliance program.
- What would the expected benefits of continuing education and licensing be? Would it be an effective way to increase the quality of advice provided to investors? Would it provide better visibility into the qualifications and education of personnel of SEC-registered investment advisers?
- What would the expected costs of continuing education and licensing be? How expensive would it be to obtain the continuing education or procure the license? Do those costs scale, or would they fall more heavily on smaller advisers? Would these requirements result in a barrier to entry that could decrease the number of advisers and advisory personnel (and thus potentially increase the cost of advice)?
- What would the effects be of continuing education and licensing for investment adviser personnel in the market for investment advice (*i.e.,* as compared to broker-dealers)?
- What other types of qualification requirements should be considered, such as minimum experience requirements or standards regarding an individual's fitness for serving as an investment adviser representative?

B. Provision of Account Statements

Fees and costs are important to retail investors,[68] but many retail investors are uncertain about the fees they will pay.[69] The relationship summary that we are proposing in a concurrent release would discuss certain differences between advisory and brokerage fees to provide investors more clarity concerning the key categories of fees and expenses they should expect to pay, but would not require more complete, specific or personalized disclosures or disclosures about the amount of fees and expenses.[70] We believe that delivery of periodic account statements, if they specified the dollar amounts of

FINRA, a registered national securities association, and may choose to become exchange members. *See* Exchange Act section 15(b)(8) and Exchange Act rule 15b9–1. FINRA is the sole national securities association registered with the SEC under section 15A of the Exchange Act.

[63] *See* NASD Rule 1021 (''Registration Requirements''); NASD Rule 1031 (''Registration Requirements''); NASD Rule 1041 (''Registration Requirements for Assistant Representatives''); FINRA Rule 1250 (''Continuing Education Requirements'').

[64] *See* 913 Study, *supra* note 38, at 86. *See also* Advisers Act rule 203A–3(a) (definition of ''investment adviser representative'').

[65] *See* 913 Study, *supra* note 38, at 86–87, 138. The North American Securities Administrators Association (''NASAA'') is considering a potential model rule that would require that investment adviser representatives meet a continuing education requirement in order to maintain their state registrations. An internal survey of NASAA's membership identified strong support for such a requirement along with significant regulatory need. NASAA is now conducting a nationwide survey of relevant stakeholders to get their input and views on such a requirement. For more information, see *http://www.nasaa.org/industry-resources/investment-advisers/nasaa-survey-regarding-continuing-education-for-investment-adviser-representatives/.*

[66] Several commenters, cited in the 913 Study, suggested that this was a gap that should be addressed. *See* 913 Study, *supra* note 38, at 138 (citing letters from AALU, Bank of America, FSI, Hartford, LPL, UBS, and Woodbury).

[67] *See* 913 Study, *supra* note 38, at 138.

[68] *See* Staff of the Securities and Exchange Commission, *Study Regarding Financial Literacy Among Investors as required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Aug. 2012), at iv, *available at https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf* (''With respect to financial intermediaries, investors consider information about fees, disciplinary history, investment strategy, conflicts of interest to be absolutely essential.'').

[69] *See* Angela A. Hung, et al., RAND Institute for Civil Justice, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008), at xix, *available at https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf* (''In fact, focus-group participants with investments acknowledged uncertainty about the fees they pay for their investments, and survey responses also indicate confusion about the fees.'').

[70] *See* Form CRS Proposal, *supra* note 6, at Section II.B.4.

fees and expenses, would allow clients to readily see and understand the fees and expenses they pay for an adviser's services. Clients would receive account statements close in time to the assessment of periodic account fees, which could be an effective way for clients to understand and evaluate the cost of the services they are receiving from their advisers.

Broker-dealers are required to provide confirmations of transactions with detailed information concerning commissions and certain other remuneration, as well as account statements containing a description of any securities positions, money balances or account activity during the period since the last statement was sent to the customer.[71] Broker-dealers generally must provide account statements no less than once every calendar quarter. Brokerage customers must receive periodic account statements even when not receiving immediate trade confirmations.[72] Although we understand that many advisers do provide clients with account statements, advisers are not directly required to provide account statements under the federal securities laws. Notably, however, the custody rule requires advisers with custody of a client's assets to have a reasonable basis for believing that the qualified custodian sends an account statement at least quarterly.[73] In addition, in any separately managed account program relying on rule 3a–4 under the Investment Company Act of 1940, the program sponsor or another person designated by the sponsor must provide clients statements at least quarterly containing specified information.[74]

We request comment on whether we should propose rules to require registered investment advisers to provide account statements, either directly or via the client's custodian, regardless of whether the adviser is deemed to have custody of client assets under Advisers Act Rule 206(4)–2 or the adviser is a sponsor (or a designee of a sponsor) of a managed account program relying on the safe harbor in Investment Company Act rule 3a–4.

- To what extent do retail clients of registered investment advisers already receive account statements? To what extent do those account statements specify the dollar amounts charged for advisory fees and other fees (*e.g.,* brokerage fees) and expenses? Would retail clients benefit from a requirement that they receive account statements from registered investment advisers? If clients are uncertain about what fees and expenses they will pay, would they benefit from a requirement that, before receiving advice from a registered investment adviser, they enter into a written (including electronic) agreement specifying the fees and expenses to be paid?
- What information, in addition to fees and expenses, would be most useful for retail clients to receive in account statements? Should any requirement to provide account statements have prescriptive requirements as to presentation, content, and delivery? Should they resemble the account statements required to be provided by broker-dealers, under NASD Rule 2340 with the addition of fee disclosure?
- How often should clients receive account statements?
- How costly would it be to provide account statements? Does that cost depend on how those account statements could be delivered (*e.g.,* via U.S. mail, electronic delivery, notice and access)? Are there any other factors that would impact cost?

C. Financial Responsibility

Broker-dealers are subject to a comprehensive financial responsibility program. Pursuant to Exchange Act rule 15c3–1 (the net capital rule), broker-dealers are required to maintain minimum levels of net capital designed to ensure that a broker-dealer under financial stress has sufficient liquid assets to satisfy all non-subordinated liabilities without the need for a formal liquidation proceeding.[75] Exchange Act rule 15c3–3 (the customer protection rule) requires broker-dealers to segregate customer assets and maintain them in a manner designed to ensure that should the broker-dealer fail, those assets are readily available to be returned to customers.[76] Broker-dealers are also subject to extensive recordkeeping and reporting requirements, including an annual audit requirement as well as a requirement to make their audited balance sheets available to customers.[77] Broker-dealers are required to be members of the Securities Investor Protection Corporation (''SIPC''), which is responsible for overseeing the liquidation of member broker-dealers that close due to bankruptcy or financial trouble and customer assets are missing. When a brokerage firm is closed and customer assets are missing, SIPC, within certain limits, works to return customers' cash, stock, and other securities held by the firm. If a firm closes, SIPC protects the securities and cash in a customer's brokerage account up to $500,000, including up to $250,000 protection for cash in the account.[78] Finally, FINRA rules require that broker-dealers obtain fidelity bond coverage from an insurance company.[79]

Under Advisers Act rule 206(4)–2, investment advisers with custody must generally maintain client assets with a ''qualified custodian,'' which includes banks and registered broker-dealers, and must comply with certain other requirements.[80] In 2009 the Commission adopted amendments to the custody requirements for investment advisers that, among other enhancements, required all registered investment advisers with custody of client assets to undergo an annual surprise examination by an independent public accountant. SEC-registered investment advisers, however, are not subject to any net capital requirements comparable to those applicable to broker-dealers, although they must disclose any material financial condition that impairs their ability to provide services to their clients.[81] Many investment advisers have relatively small amounts of capital, particularly compared to the amount of assets that they have under management.[82] When we discover a serious fraud by an adviser, often the assets of the adviser are insufficient to compensate clients for their loss. In addition, investment advisers are not required to obtain fidelity bonds, unlike

[71] *See, e.g.,* NASD Rule 2340; FINRA Rule 2232; MSRB Rule G–15. *See also* Exchange Act rule 15c3–2 (account statements); Exchange Act rule 10b–10 (confirmation of transactions).

[72] *See* Confirmation of Transactions, Securities Exchange Act Release No. 34962 (November 10, 1994).

[73] Advisers Act rule 206(4)–2(a)(3) (custody rule). The Commission also has stated that an adviser's policies and procedures, at a minimum, should address the accuracy of disclosures made to investors, clients, and regulators, including account statements.

[74] Investment Company Act of 1940 [15 U.S.C. 80a–1 *et seq.*] (''Investment Company Act'') rule 3a–4(a)(4).

[75] *See* Exchange Act rule 15c3–1.

[76] *See* Exchange Act rule 15c3–3.

[77] *See* Exchange Act rules 17a–3, 17a–4, and 17a–5.

[78] *See* Securities Investor Protection Act of 1970, Public Law 91–598, 84 Stat. 1636 (Dec. 30, 1970), 15 U.S.C. 78aaa through 15 U.S.C. 78lll.

[79] *See* FINRA Rule 4360, (''Fidelity Bonds'').

[80] *See* Advisers Act rule 206(4)–2.

[81] *See* Form ADV. Many states have imposed fidelity bonding and/or net capital requirements on state-registered investment advisers. Rule 17g–1 under the Investment Company Act of 1940 requires registered investment companies to obtain fidelity bonds covering their officers and employees who may have access to the investment companies' assets.

[82] *See* Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Release No. 2968 (Dec. 30, 2009).

many other financial service providers that have access to client assets.[83]

In light of these disparities, we request comment on whether SEC-registered investment advisers should be subject to financial responsibility requirements along the lines of those that apply to broker-dealers.

• What is the frequency and severity of client losses due to investment advisers' inability to satisfy a judgment or otherwise compensate a client for losses due to the investment adviser's wrongdoing?

• Should investment advisers be subject to net capital or other financial responsibility requirements in order to ensure they can meet their obligations, including compensation for clients if the adviser becomes insolvent or advisory personnel misappropriate clients' assets?[84] Do the custody rule and other rules[85] under the Advisers Act adequately address the potential for misappropriation of client assets and other financial responsibility concerns for advisers? Should investment advisers be subject to an annual audit requirement?

• Should advisers be required to obtain a fidelity bond from an insurance company? If so, should some advisers be excluded from this requirement?[86] Is there information or data that demonstrates fidelity bonding requirements provide defrauded clients with recovery, and if so what amount or level of recovery is evidenced?

• Alternatively, should advisers be required to maintain a certain amount of capital that could be the source of compensation for clients?[87] What amount of capital would be adequate?[88]

• What would be the expected cost of either maintaining some form of reserve capital or purchasing a fidelity bond? Specifically, in addition to setting aside the initial sum or purchasing the initial bond, what would be the ongoing cost and the opportunity cost for investment advisers? Would one method or the other be more feasible for certain types of investment advisers (particularly, smaller advisers)?

• Would the North American Securities Administrators Association Minimum Financial Requirements For Investment Advisers Model Rule 202(d)–1[89] (which requires, among other things, an investment adviser who has custody of client funds or securities to maintain at all times a minimum net worth of $35,000 (with some exceptions), an adviser who has discretionary authority but not custody over client funds or securities to maintain at all times a minimum net worth of $10,000, and an adviser who accepts prepayment of more than $500 per client and six or more months in advance to maintain at all times a positive net worth), provide an appropriate model for a minimum capital requirement? Why or why not?

• Although investment advisers are required to report specific information about the assets that they manage on behalf of clients, they are not required to report specific information about their own assets.[90] Should advisers be required to obtain annual audits of their own financials and to provide such information on Form ADV? Would such a requirement raise privacy concerns for privately held advisers?

By the Commission.

Dated: April 18, 2018.

Brent J. Fields,

Secretary.

[FR Doc. 2018–08679 Filed 5–8–18; 8:45 am]

BILLING CODE 8011–01–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 151

[Docket No. USCG–2018–0245]

RIN 1625–AC45

Ballast Water Management—Annual Reporting Requirement

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes to amend its regulations on ballast water management by eliminating the requirement for vessels operating on voyages exclusively between ports or places within a single Captain of the Port Zone to submit an Annual Ballast Water Summary Report for calendar year 2018. The Coast Guard views this current reporting requirement as unnecessary to analyze and understand ballast water management practices. This proposal would also serve to reduce the administrative burden on the

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[83] Fidelity bonds are required to be obtained by broker-dealers (FINRA Rule 4360; New York Stock Exchange Rule 319; American Stock Exchange Rule 330); transfer agents (New York Stock Exchange Rule Listed Company Manual § 906); investment companies (17 CFR 270.17g–1); national banks (12 CFR 7.2013); federal savings associations (12 CFR 563.190).

[84] We note that Congress and the Commission have considered such requirements in the past. In 1973, a Commission advisory committee recommended that Congress authorize the Commission to adopt minimum financial responsibility requirements for investment advisers, including minimum capital requirements. *See* Report of the Advisory Committee on Investment Management Services for Individual Investors, Small Account Investment Management Services, Fed. Sec. L. Rep. (CCH) No. 465, Pt. III, 64–66 (Jan. 1973) (''Investment Management Services Report''). Three years later, in 1976, the Senate Committee on Banking, Housing and Urban Affairs considered a bill that, among other things, would have authorized the Commission to adopt rules requiring investment advisers (i) with discretionary authority over client assets, or (ii) that advise registered investment companies, to meet financial responsibility standards. S. Rep. No. 94–910, 94th Cong. 2d Sess. (May 20, 1976) (reporting favorably S. 2849). S. 2849 was never enacted. In 1992, both the Senate and House of Representatives passed bills that would have given the Commission the explicit authority to require investment advisers with custody of client assets to obtain fidelity bonds. S. 226, 102d Cong., 2d Sess. (Aug. 12, 1992) and H.R. 5726, 102d Cong. Ed (Sept. 23, 1992). Differences in these two bills were never reconciled and thus neither became law. In 2003, the Commission requested comment on whether to require a fidelity bonding requirement for advisers as a way to increase private sector oversight of the compliance by funds and advisers with the federal securities laws. The Commission decided not to adopt a fidelity bonding requirement at that time, but noted that it regarded such a requirement as a viable option should the Commission wish to further strengthen compliance programs of funds and advisers. Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 25925 (Feb. 5, 2003).

[85] *See, e.g.,* Advisers Act rule 206(4)–7 (requires each investment adviser registered or required to be registered with the Commission to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and Advisers Act rules, review those policies and procedures annually, and designate an individual to serve as a chief compliance officer).

[86] As noted above, the 1992 legislation would have given us the explicit authority to require bonding of advisers that have custody of client assets or that have discretionary authority over client assets. Section 412 of ERISA [29 U.S.C. 1112] and related regulations (29 CFR 2550.412–1 and 29 CFR 2580) generally require that every fiduciary of an employee benefit plan and every person who handles funds or other property of such a plan shall be bonded. Registered investment advisers exercising investment discretion over assets of plans covered by title I of ERISA are subject to this requirement; it does not apply to advisers who exercise discretion with respect to assets in an individual retirement account or other non-ERISA retirement account. In 1992, only approximately three percent of Commission registered advisers had discretionary authority over client assets; as of March 31, 2018, according to data collected on Form ADV, 91 percent of Commission registered advisers have that authority.

[87] *See supra* note 84.

[88] Section 412 of ERISA provides that the bond required under that section must +be at least ten percent of the amount of funds handled, with a maximum required amount of $500,000 (increased to $1,000,000,000 for plans that hold securities issued by an employer of employees covered by the plan).

[89] NASAA Minimum Financial Requirements For Investment Advisers Model Rule 202(d)–1 (Sept. 11, 2011), *available at http://www.nasaa.org/wp-content/uploads/2011/07/IA-Model-Rule-Minimum-Financial-Requirements.pdf.*

[90] Form ADV only requires that advisers with significant assets (at least $1 billion) report the approximate amount of their assets within one of the three ranges ($1 billion to less than $10 billion, $10 billion to less than $50 billion, and $50 billion or more). Item 1.O of Part 1A of Form ADV.

TAB 4

VII. Consideration of the Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or ''SBREFA,'' [1032] we must advise OMB whether a proposed regulation constitutes a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it results in or is likely to result in (1) an annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effects on competition, investment or innovation.

We request comment on the potential effect of the proposed amendments on the U.S. economy on an annual basis; any potential increase in costs or prices for consumers or individual industries; and any potential effect on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VIII. Statutory Authority

The Commission is proposing amendments to rule 203–1 under the Advisers Act pursuant to authority set forth in sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–3(c)(1), 80b–4, and 80b–11(a)].

The Commission is proposing amendments to rule 204–1 under the Advisers Act pursuant to authority set forth in sections 203(c)(1) and 204 of the Investment Advisers Act of 1940 [15 U.S.C. 80b–3(c)(1) and 80b–4].

The Commission is proposing new rule 204–5 under the Advisers Act pursuant to authority set forth in sections 204, 206A, 206(4), 211(a), and 211(h) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–4, 80b–6a, 80b–6(4), 80b–11(a), 80b–11(h)], and section 913(f) of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the ''Dodd-Frank Act'').

The Commission is proposing amendments to rule 279.1, Form ADV, under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 7sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 80a–37(a)], and sections 203(c)(1), 204, 206A, 211(a) and 211(h), and of the Investment Advisers Act of 1940 [15 U.S.C. 80b–3(c)(1), 80b–4, 80b–6a, 80b–11(a) and 80b–11(h)], and section 913(f) of Title IX of the Dodd-Frank Act.

The Commission is proposing to amend rule 204–2 under the Advisers Act pursuant to authority set forth in sections 204 and 211 of the Advisers Act [15 U.S.C. 80b–4 and 80b–11].

The Commission is proposing new rule 17a–14 under the Exchange Act, Form CRS, and amendments to rules 17a–3 and 17a–4 under the Exchange Act pursuant to the authority set forth in the Exchange Act and particularly sections 3, 10, 15, 17, 23 and 36 thereof 15 U.S.C. 78c, 78j, 78o, 78q, 78w and 78mm, and section 913(f) of Title IX of the Dodd-Frank Act.

The Commission is proposing new rules 15*l*–2 and 15*l*–3 under the authority set forth in sections 10, 15, 23, and 36 of the Securities Exchange Act of 1934 [15 U.S.C. 78j, 78o, 78w, and 78mm] and new rule 211h–1 under the authority set forth in sections 211(h), 206A, 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–11(h), 80b–6a, 80b–11(a)].

IX. Text of Rule and Form

List of Subjects

17 CFR Parts 240 and 249

Brokers, Reporting and recordkeeping requirements, Sales practice and disclosure requirements, Securities.

17 CFR Parts 275 and 279

Investment advisers, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rules

For the reasons set out in the preamble, title 17, chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The general authority citation for part 240 continues to read as follows and sectional authorities for 240.15*l*–2, 240.15*l*–3, and 240.17a–14 are added to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c–3, 78c–5, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l,* 78m, 78n, 78n–1, 78*o,* 78*o*–4, 78*o*–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78*ll,* 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, 7201 *et seq.;* and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111–203, 939A, 124 Stat. 1887 (2010); and secs. 503 and 602, Pub. L. 112–106, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

Section 240.15*l*–2 is also issued under Public Law 111–203, sec. 913, 124 Stat. 1376 (2010).

Section 240.15*l*–3 is also issued under Public Law 111–203, sec. 913, 124 Stat. 1376 (2010).

Section 240.17a–14 is also issued under Public Law 111–203, sec. 913, 124 Stat. 1376 (2010).

* * * * *

■ 2. Section 240.15l–2 is added to read as follows:

§ 240.15*l*–2 Use of the Term "Adviser" or "Advisor".

(a) A broker or dealer, or a natural person who is an associated person of a broker or dealer shall be restricted, when communicating with a retail investor, from using as part of a name or title the term ''adviser'' or ''advisor'' unless any such:

(1) Broker or dealer is an investment adviser registered under Section 203 of the Investment Advisers Act of 1940 or with a State, or

(2) Natural person who is an associated person of a broker or dealer is a supervised person of an investment adviser registered under Section 203 of the Investment Advisers Act of 1940 or with a State, and such person provides investment advice on behalf of such investment adviser.

(b) The term *retail investor* has the meaning set forth in § 240.17a–14.

■ 3. Section 240.15l–3 is added to read as follows:

§ 240.15*l*-3 Disclosure of Registration Status.

(a) A broker or dealer shall prominently disclose that it is registered with the Commission as a broker-dealer in print or electronic retail investor communications.

(b) A natural person who is an associated person of a broker or dealer shall prominently disclose that he or she is an associated person of a broker-dealer registered with the Commission in print or electronic retail investor communications.

(c) Such disclosures in paragraphs (a) and (b) shall be provided in the following manner:

(1) For print communications, such status must be displayed in a type size at least as large as and of a font style different from, but at least as prominent as, that used in the majority of the communication. In addition, such disclosure must be presented in the body of the communication and not in a footnote.

(2) For electronic communications, or in any publication by radio or television, such disclosure must be presented in a manner reasonably calculated to draw retail investor attention to it.

[1032] Public Law 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

(d) The term *retail investor* has the meaning set forth in § 240.17a–14.

■ 4. Section 240.17a–3 is amended by adding paragraph (a)(24) to read as follows:

§ 240.17a–3 Records to be made by certain exchange members, brokers and dealers.

(a) * * *

(24) A record of the date that each Form CRS was provided to each retail investor, including any Form CRS provided before such retail investor opens an account.

* * * * *

■ 5. Section 240.17a–4 is amended by adding paragraph (e)(10) to read as follows:

§ 240.17a–4 Records to be preserved by certain exchange members, brokers and dealers.

* * * * *

(e) * * *

(10) All records required pursuant to § 240.17a–3(a)(24), as well as a copy of each Form CRS, until at least six years after such record or Form CRS is created.

* * * * *

■ 6. Section 240.17a–14 is added to read as follows:

§ 240.17a–14 Form CRS, for preparation, filing and delivery of Form CRS.

(a) *Scope of Section.* This section shall apply to every broker or dealer registered with the Commission pursuant to section 15 of the Act that offers services to a retail investor.

(b) *Form CRS.* You must:

(1) Prepare Form CRS 17 CFR 249.640, by following the instructions in the form.

(2) File your current Form CRS electronically with the Commission through the Commission's EDGAR system, and thereafter, file an amended Form CRS in accordance with the instructions in the form.

(3) Amend your Form CRS as required by the instructions in the form.

(c) *Delivery of Form CRS.* You must:

(1) Deliver to each retail investor your current Form CRS before or at the time the retail investor first engages your services.

(2) Deliver to each retail investor who is an existing customer your current Form CRS before or at the time (i) a new account is opened that is different from the retail investor's existing account(s); or (ii) changes are made to the retail investor's existing account(s) that would materially change the nature and scope of the relationship with the retail investor, including before or at the time you recommend that the retail investor transfers from an advisory account to a brokerage account, transfers from a brokerage account to an advisory account, or moves assets from one type of account to another in a transaction not in the normal, customary or already agreed course of dealing. Whether a change would require delivery of the Form CRS would depend on the specific facts and circumstances.

(3) Post the current Form CRS prominently on your website, if you have one, in a location and format that is easily accessible for retail investors.

(4) Communicate any changes made to Form CRS to each retail investor who is an existing customer within 30 days after the amendments are required to be made and without charge. The communication can be made by delivering the current Form CRS or by communicating the information in another way to the retail investor.

(5) Deliver a current Form CRS to each retail investor within 30 days upon request.

(d) *Other disclosure obligations.* Delivering a Form CRS in compliance with this section does not relieve you of any other disclosure obligations arising under the federal securities laws and regulations or other laws or regulations (including the rules of a self-regulatory organization).

(e) *Definitions.* For purposes of this section:

(1) *Current Form CRS* means the most recent version of the Form CRS.

(2) *Retail investor* means a customer or prospective customer who is a natural person (an individual). This term includes a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust.

(f) *Transition rule.* (1) You must begin to comply with this section by [INSERT DATE SIX MONTHS AFTER EFFECTIVE DATE OF RULES/FORM], including by filing your Form CRS in accordance with paragraph (b)(2) of this section by that date.

(2) Within 30 days after the date by which you are first required by paragraph (f)(1) of this section to electronically file your Form CRS with the Commission, you must deliver to each of your existing customers who is a retail investor your current Form CRS.

(3) After [INSERT DATE SIX MONTHS AFTER EFFECTIVE DATE OF RULES/FORM], if you are a newly registered broker or dealer that is subject to this section, you must begin to comply with this section by the date on which your registration with the Commission becomes effective pursuant to Section 15(b) of the Act, including by filing your Form CRS in accordance with paragraph (b)(2) of this section by that date.

Editorial Note: For **Federal Register** citations affecting Form CRS, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at *www.fdsys.gov.*

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

■ 7. The authority citation for part 249 is amended by adding sectional authorities to read as follows:

Authority: 15 U.S.C. 78a *et seq.* and 7201 *et seq.;* 12 U.S.C. 5461 *et seq.;* 18 U.S.C. 1350; Sec. 953(b), Pub. L. 111–203, 124 Stat. 1904; Sec. 102(a)(3), Pub. L. 112–106, 126 Stat. 309 (2012); Sec. 107, Pub. L. 112–106, 126 Stat. 313, (2012), and Sec. 72001, Pub. L. 114–94, 129 Stat. 1312 (2015), unless otherwise noted.

* * * * *

Section 249.640 is also issued under Public Law 111–203, sec. 913, 124 Stat. 1376 (2010).

* * * * *

■ 8. Section 249.640 is added to read as follows:

§ 249.640 Form CRS, Relationship Summary for Broker-Dealers Providing Services to Retail Investors, pursuant to § 240.17a–14 of this chapter.

This form shall be prepared and filed by broker-dealers registered with the Securities and Exchange Commission pursuant to Section 15 of the Act that offer services to a retail investor pursuant to § 240.17a–14 of this chapter.

PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

■ 9. The general authority citation for part 275 continues to read as follows and sectional authorities for 275.204–5 and 275.211h–1 are added to read as follows:

Authority: 15 U.S.C. 80b–2(a)(11)(G), 80b–2(a)(11)(H), 80b–2(a)(17), 80b–3, 80b–4, 80b–4a, 80b–6(4), 80b–6a, and 80b–11, unless otherwise noted.

* * * * *

Section 275.204–5 is also issued under sec. 913, Public Law 111–203, sec. 124 Stat. 1827–28 (2010).

Section 275.211h–1 is also issued under sec. 913, Public Law 111–203, sec. 124 Stat. 1827–28 (2010).

* * * * *

■ 10. Amend § 275.203–1 by revising paragraph(a) to read as follows:

§ 275.203–1 Application for investment adviser registration.

(a) *Form ADV.* (1) To apply for registration with the Commission as an investment adviser, you must complete Form ADV (17 CFR 279.1) by following the instructions in the form and you must file Part 1A of Form ADV, the firm brochure(s) required by Part 2A of Form ADV and Form CRS required by Part 3 of Form ADV electronically with the Investment Adviser Registration Depository (IARD) unless you have received a hardship exemption under § 275.203–3. You are not required to file with the Commission the brochure supplements required by Part 2B of Form ADV.

(2) After [INSERT DATE SIX MONTHS AFTER EFFECTIVE DATE OF RULES/FORM] the Commission will not accept any initial application for registration as an investment adviser that does not include a Form CRS that satisfies the requirements of Part 3 of Form ADV.

Note to paragraph (a)(1): Information on how to file with the IARD is available on the Commission's Web site at *http://www.sec.gov/iard.* If you are not required to deliver a brochure or Form CRS to any clients, you are not required to prepare or file a brochure or Form CRS, as applicable, with the Commission. If you are not required to deliver a brochure supplement to any clients for any particular supervised person, you are not required to prepare a brochure supplement for that supervised person.

* * * * *

■ 11. Amend § 275.204–1 by revising paragraphs (a) and (b) to read as follows:

§ 275.204–1 Amendments to Form ADV.

(a) *When amendment is required.* You must amend your Form ADV (17 CFR 279.1):

(1) Parts 1 and 2:

(i) At least annually, within 90 days of the end of your fiscal year; and

(ii) More frequently, if required by the instructions to Form ADV.

(2) Part 3 at the frequency required by the instructions to Form ADV.

(b) *Electronic filing of amendments.* (1) Subject to paragraph (b)(3) of this rule, you must file all amendments to Part 1A, Part 2A and Part 3 of Form ADV electronically with the IARD, unless you have received a continuing hardship exemption under § 275.203–3. You are not required to file with the Commission amendments to brochure supplements required by Part 2B of Form ADV.

(2) If you have received a continuing hardship exemption under § 275.203–3, you must, when you are required to amend your Form ADV, file a completed Part 1A, Part 2A and Part 3 of Form ADV on paper with the SEC by mailing it to FINRA.

(3) Transition to filing Form CRS. You must amend your Form ADV by electronically filing with the IARD Form CRS that satisfies the requirements of Part 3 of Form ADV (as amended effective [INSERT EFFECTIVE DATE OF RULES/FORM]) as part of the next annual updating amendment you are required to file after [INSERT DATE SIX MONTHS AFTER EFFECTIVE DATE OF RULES/FORM].

Note to paragraphs (a) and (b): Information on how to file with the IARD is available on our Web site at *http://www.sec.gov/iard.* For the annual updating amendment: Summaries of material changes that are not included in the adviser's brochure must be filed with the Commission as an exhibit to Part 2A in the same electronic file; and if you are not required to prepare a brochure, a summary of material changes, an annual updating amendment to your brochure, or Form CRS you are not required to file them with the Commission. See the instructions for Part 2A and Part 3 of Form ADV.

* * * * *

■ 12. Section 275.204–2 is amended by revising paragraph (a)(14)(i) as follows:

§ 275.204–2 Books and records to be maintained by investment advisers.

(a) * * *

(14)

(i) A copy of each brochure, brochure supplement and Form CRS, and each amendment or revision to the brochure, brochure supplement and Form CRS, that satisfies the requirements of Part 2 or Part 3 of Form ADV, as applicable [17 CFR 279.1]; any summary of material changes that satisfies the requirements of Part 2 of Form ADV but is not contained in the brochure; and a record of the dates that each brochure, brochure supplement and Form CRS, each amendment or revision thereto, and each summary of material changes not contained in a brochure was given to any client or to any prospective client who subsequently becomes a client.

* * * * *

■ 13. Section 275.204–5 is added to read as follows:

§ 275.204–5 Delivery of Form CRS.

(a) *General requirements.* If you are registered under the Act as an investment adviser, you must deliver Form CRS, required by Part 3 of Form ADV [17 CFR 279.1], to each retail investor.

(b) *Delivery requirements.* You (or a supervised person acting on your behalf) must:

(1) Deliver to each retail investor your current Form CRS before or at the time you enter into an investment advisory contract with that retail investor.

(2) Deliver to each retail investor who is an existing client your current Form CRS before or at the time (i) a new account is opened that is different from the retail investor's existing account(s); or (ii) changes are made to the retail investor's existing account(s) that would materially change the nature and scope of the relationship with the retail investor, including before or at the time you recommend that the retail investor transfers from an advisory account to a brokerage account, transfers from a brokerage account to an advisory account, or moves assets from one type of account to another in a transaction not in the normal, customary or already agreed course of dealing. Whether a change would require delivery of the Form CRS would depend on the specific facts and circumstances.

(3) Post the current Form CRS prominently on your website, if you have one, in a location and format that is easily accessible for retail investors.

(4) Communicate any changes made to Form CRS to each retail investor who is an existing client within 30 days after the amendments are required to be made and without charge. The communication can be made by delivering the amended Form CRS or by communicating the information in another way to the retail investor.

(5) Deliver a current Form CRS to each retail investor within 30 days upon request.

(c) *Other disclosure obligations.* Delivering Form CRS in compliance with this section does not relieve you of any other disclosure obligations you have to your retail investors under any federal or state laws or regulations.

(d) *Definitions.* For purposes of this section:

(1) *Current Form CRS* means the most recent version of the Form CRS.

(2) *Retail investor* means a client or prospective client who is a natural person (an individual). This term includes a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust.

(3) *Supervised person* means any of your officers, partners or directors (or other persons occupying a similar status or performing similar functions) or employees, or any other person who provides investment advice on your behalf.

(e) *Transition rule.*

(1) Within 30 days after the date by which you are first required by § 275.204–1(b)(3) to electronically file your Form CRS with the Commission, you must deliver to each of your existing clients who is a retail investor your current Form CRS as required by Part 3 of Form ADV.

(2) As of the date by which you are first required to electronically file your Form CRS with the Commission, you must begin using your Form CRS as required by Part 3 of Form ADV to

comply with the requirements of paragraph (b) of this section.

■ 14. Section 275.211h–1 is added to read as follows:

§ 275.211h–1 Disclosure of Registration Status.

(a) An investment adviser registered under section 203 of the Act shall prominently disclose that it is registered with the Commission as an investment adviser in print or electronic retail investor communications.

(b) A supervised person of an investment adviser registered under section 203 of the Act shall prominently disclose that he or she is a supervised person of an investment adviser registered with the Commission in print or electronic retail investor communications.

(c) Such disclosures in paragraphs (a) and (b) of this section shall be provided in the following manner:

(1) For print communications, such status must be displayed in a type size at least as large as and of a font style different from, but at least as prominent as, that used in the majority of the communication. In addition, such disclosure must be presented in the body of the communication and not in a footnote.

(2) For electronic communications, or in any publication by radio or television, such disclosure must be presented in a manner reasonably calculated to draw retail investor attention to it.

(d) The term *retail investor* has the meaning set forth in Rule 204–5 (§ 275.204–5 of this chapter).

PART 279—FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

■ 15. The authority citation for part 279 is revised to read as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b–1, et seq., Pub. L. 111–203, 124 Stat. 1376.

■ 16. Form ADV [referenced in § 279.1] is amended by:

■ a. In the instructions to the form, revising the section entitled ''Form ADV: General Instructions.'' The revised version of Form ADV: General Instructions is attached as Appendix A;

■ b. In the instructions to the form, adding the section entitled ''Form ADV, Part 3: Instructions to Form CRS.'' The new version of Form ADV, Part 3: Instructions to Form CRS is attached as Appendix B.

By the Commission.

Dated: April 18, 2018.

Brent J. Fields,

Secretary.

Note: The text of Form ADV does not and the amendments will not appear in the Code of Federal Regulations.

Appendices

APPENDIX A

FORM ADV (Paper Version)

• UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND

• REPORT FORM BY EXEMPT REPORTING ADVISERS

Form ADV: General Instructions

Read these instructions carefully before filing Form ADV. Failure to follow these instructions, properly complete the form, or pay all required fees may result in your application or report being delayed or rejected.

In these instructions and in Form ADV, ''you'' means the investment adviser (*i.e.*, the advisory firm).

If you are a ''separately identifiable department or division'' (SID) of a bank, ''you'' means the SID, rather than your bank, unless the instructions or the form provide otherwise.

If you are a *private fund* adviser filing an *umbrella registration*, ''you'' means the *filing adviser* and each *relying adviser*, unless the instructions or the form provide otherwise. The information in Items 1, 2, 3 and 10 (including corresponding schedules) should be provided for the *filing adviser* only.

Terms that appear in *italics* are defined in the Glossary of Terms to Form ADV.

1. Where can I get more information on Form ADV, electronic filing, and the IARD?

The SEC provides information about its rules and the Advisers Act on its website: <http://www.sec.gov/iard>.

NASAA provides information about state investment adviser laws and state rules, and how to contact a *state securities authority*, on its website: <http://www.nasaa.org>.

FINRA provides information about the IARD and electronic filing on the IARD website: <http://www.iard.com>.

2. What is Form ADV used for?

Investment advisers use Form ADV to:

- Register with the Securities and Exchange Commission
- Register with one or more *state securities authorities*
- Amend those registrations;
- Report to the SEC as an *exempt reporting adviser*
- Report to one or more *state securities authorities* as an *exempt reporting adviser*
- Amend those reports; and
- Submit a final report as an *exempt reporting adviser*

3. How is Form ADV organized?

Form ADV contains five parts:

- Part 1A asks a number of questions about you, your business practices, the *persons* who own and *control* you, and the *persons* who provide investment advice on your behalf.
  - ○ All advisers registering with the SEC or any of the *state securities authorities* must complete Part 1A.
  - ○ *Exempt reporting advisers* (that are not also registering with any *state securities authority*) must complete only the following Items of Part 1A: 1, 2, 3, 6, 7, 10, and 11, as well as corresponding schedules. *Exempt reporting advisers* that are registering with any *state securities authority* must complete all of Form ADV.

  Part 1A also contains several supplemental schedules. The items of Part 1A let you know which schedules you must complete.
  - ○ Schedule A asks for information about your direct owners and executive officers.
  - ○ Schedule B asks for information about your indirect owners.
  - ○ Schedule C is used by paper filers to update the information required by Schedules A and B (see Instruction 18).
  - ○ Schedule D asks for additional information for certain items in Part 1A.
  - ○ Schedule R asks for additional information about *relying advisers*.
  - ○ Disclosure Reporting Pages (or DRPs) are schedules that ask for details about disciplinary events involving you or your *advisory affiliates*.
- Part 1B asks additional questions required by *state securities authorities*. Part 1B contains three additional DRPs. If you are applying for SEC registration or are registered only with the SEC, you do not have to complete Part 1B. (If you are filing electronically and you do not have to complete Part 1B, you will not see Part 1B).
- Part 2A requires advisers to create narrative *brochures* containing information about the advisory firm. The requirements in Part 2A apply to all investment advisers registered with or applying for registration with the SEC, but do not apply to *exempt reporting advisers*. Every application for registration must include a narrative brochure prepared in accordance with the requirements of Part 2A of Form ADV. See Advisers Act Rule 203-1.
- Part 2B requires advisers to create *brochure supplements* containing information about certain *supervised persons*. The requirements in Part 2B apply to all investment advisers registered with or applying for registration with the SEC, but do not apply to *exempt reporting advisers*.
- Part 3 requires advisers to create a *relationship summary* (Form CRS) containing information for *retail investors*. The requirements in Part 3 apply to all investment advisers registered or applying for registration with the SEC, but do not apply to *exempt reporting advisers*. Every adviser that has *retail investors* to whom it must deliver a *relationship summary* must include in the application for registration a *relationship summary* prepared in

accordance with the requirements of Part 3 of Form ADV. See Advisers Act Rule 203-1.

4. When am I required to update my Form ADV?

- *SEC- and State-Registered Advisers*:
  - *Annual updating amendments*: You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all items, including corresponding sections of Schedules A, B, C, and D and all sections of Schedule R for each *relying adviser*. You must submit your summary of material changes required by Item 2 of Part 2A either in the *brochure* (cover page or the page immediately thereafter) or as an exhibit to your *brochure*.
  - *Other-than-annual amendments*: In addition to your *annual updating amendment*, if you are registered with the SEC or a *state securities authority*, you must amend Part 1 and Part 2 of your Form ADV, including corresponding sections of Schedules A, B, C, D, and R, by filing additional amendments (other-than-annual amendments) *promptly*, if:
    - you are adding or removing a *relying adviser* as part of your *umbrella registration;*
    - information you provided in response to Items 1 (except 1.O. and Section 1.F. of Schedule D), 3, 9 (except 9.A.(2), 9.B.(2), 9.E., and 9.F.), or 11 of Part 1A or Items 1, 2.A. through 2.F., or 2.I. of Part 1B or Sections 1 or 3 of Schedule R becomes inaccurate in any way;
    - information you provided in response to Items 4, 8, or 10 of Part 1A, or Item 2.G. of Part 1B, or Section 10 of Schedule R becomes *materially* inaccurate; or
    - information you provided in your *brochure* becomes *materially* inaccurate (see note below for exceptions).

Notes: *Part 1*: If you are submitting an other-than-annual amendment, you are not required to update your responses to Items 2, 5, 6, 7, 9.A.(2), 9.B.(2), 9.E., 9.F., or 12 of Part 1A, Items 2.H. or 2.J. of Part 1B, Section 1.F. of Schedule D or Section 2 of Schedule R even if your responses to those items have become inaccurate.

Part 2: You must amend your *brochure supplements* (see Form ADV, Part 2B) promptly if any information in them becomes *materially* inaccurate. If you are submitting an other-than-annual amendment to your *brochure*, you are not required to update your summary of material changes as required by Item 2. You are not required to update your *brochure* between annual amendments solely because the amount of *client* assets you manage has changed or because your fee schedule has changed. However, if you are updating your *brochure* for a separate reason in between annual amendments, and the amount of *client* assets you manage listed in response to Item 4.E. or your fee schedule listed in response to Item 5.A. has become materially inaccurate, you should update that item(s) as part of the interim amendment.

- *If you are an SEC-registered adviser*, you are required to file your *brochure* amendments electronically through IARD. You are not required to file amendments to your *brochure supplements* with the SEC, but you must maintain a copy of them in your files.
- *If you are a state-registered adviser*, you are required to file your *brochure* amendments and *brochure supplement* amendments with the appropriate *state securities authorities* through IARD.
  - *Part 3 amendments*: You must amend your *relationship summary* and file your *relationship summary* amendments in accordance with the Form ADV, Part 3 (Form CRS), General Instructions, 6.
- *Exempt reporting advisers*:
  - *Annual Updating Amendments*: You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all required items, including corresponding sections of Schedules A, B, C, and D.
  - *Other-than-Annual Amendments*: In addition to your *annual updating amendment*, you must amend your Form ADV, including corresponding sections of Schedules A, B, C, and D, by filing additional amendments (other-than-annual amendments) *promptly* if:
    - information you provided in response to Items 1 (except Item 1.O. and Section 1.F. of Schedule D), 3, or 11 becomes inaccurate in any way; or
    - information you provided in response to Item 10 becomes *materially* inaccurate.

Failure to update your Form ADV, as required by this instruction, is a violation of SEC rules or similar state rules and could lead to your registration being revoked.

5. What is SEC *umbrella registration* and how can I satisfy the requirements of filing an *umbrella registration?*

An *umbrella registration* is a single registration by a *filing adviser* and one or more *relying advisers* who advise only *private funds* and certain separately managed account *clients* that are *qualified clients* and collectively conduct a single advisory business. Absent other facts suggesting that the *filing adviser* and *relying adviser*(s) conduct different businesses, *umbrella registration* is available under the following circumstances:

i. The *filing adviser* and each *relying adviser* advise only *private funds* and *clients* in separately managed accounts that are *qualified clients* and are otherwise eligible to invest in the *private funds* advised by the *filing adviser* or a *relying adviser* and whose accounts pursue investment objectives and strategies that are substantially similar or otherwise related to those *private funds*.

ii. The *filing adviser* has its *principal office and place of business* in the United States and, therefore, all of the substantive provisions of the Advisers Act and the rules thereunder apply to the *filing adviser's* and each *relying adviser's* dealings with each of its *clients*, regardless of whether any *client* of the *filing adviser* or *relying adviser* providing the advice is a *United States person*.

iii. Each *relying adviser*, its *employees* and the *persons* acting on its behalf are subject to the *filing adviser's* supervision and *control* and, therefore, each *relying adviser*, its *employees* and the *persons* acting on its behalf are ''persons associated with'' the *filing adviser* (as defined in section 202(a)(17) of the Advisers Act).

iv. The advisory activities of each *relying adviser* are subject to the Advisers Act and the rules thereunder, and each *relying adviser* is subject to examination by the SEC.

v. The *filing adviser* and each *relying adviser* operate under a single code of ethics adopted in accordance with SEC rule 204A-1 and a single set of written policies and procedures adopted and implemented in accordance with SEC rule 206(4)-7 and administered by a single chief compliance officer in accordance with that rule.

To satisfy the requirements of Form ADV while using *umbrella registration* the *filing adviser* must sign, file, and update as required, a single Form ADV (Parts 1 and 2) that relates to, and includes all information concerning, the *filing adviser* and each *relying adviser* (*e.g.*, disciplinary information and ownership information), and must include this same information in any other reports or filings it must make under the Advisers Act or the rules thereunder (*e.g.*, Form PF). The *filing adviser* and each *relying adviser* must not be prohibited from registering with the SEC by section 203A of the Advisers Act (*i.e.*, the *filing adviser* and each *relying adviser* must individually qualify for SEC registration).

Unless otherwise specified, references to ''you'' in Form ADV refer to both the *filing adviser* and each *relying adviser*. The information in Items 1, 2, 3 and 10 (including corresponding schedules) should be provided for the *filing adviser* only. A separate Schedule R should be completed for each *relying adviser*. References to ''you'' in Schedule R refer to the *relying adviser* only.

A *filing adviser* applying for registration with the SEC should complete a Schedule R for each *relying adviser*. If you are a *filing adviser* registered with the SEC and would like to add or delete *relying advisers* from an *umbrella registration*, you should file an other-than-annual amendment and add or delete Schedule Rs as needed.

Note: *Umbrella registration* is not available to *exempt reporting advisers*.

6. Where do I sign my Form ADV application or amendment?

You must sign the appropriate Execution Page. There are three Execution Pages at the end of the form. Your initial application, your initial report (in the case of an *exempt reporting adviser*), and all amendments to Form ADV must include at least one Execution Page.

- If you are applying for or are amending your SEC registration, or if you are reporting as an *exempt reporting adviser* or amending your report, you must sign and submit either a:
  - Domestic Investment Adviser Execution Page, if you (the advisory firm) are a resident of the United States; or

  - *Non-Resident* Investment Adviser Execution Page, if you (the advisory firm) are not a resident of the United States.
- If you are applying for or are amending your registration with a *state securities authority*, you must sign and submit the State-Registered Investment Adviser Execution Page.

7. Who must sign my Form ADV or amendment?

The individual who signs the form depends upon your form of organization:
- For a sole proprietorship, the sole proprietor.
- For a partnership, a general partner.
- For a corporation, an authorized principal officer.
- For a ''separately identifiable department or division'' (SID) of a bank, a principal officer of your bank who is directly engaged in the management, direction, or supervision of your investment advisory activities.
- For all others, an authorized individual who participates in managing or directing your affairs.

The signature does not have to be notarized, and in the case of an electronic filing, should be a typed name.

8. How do I file my Form ADV?

Complete Form ADV electronically using the Investment Adviser Registration Depository (IARD) if:
- You are filing with the SEC (and submitting *notice filings* to any of the *state securities authorities*), or
- You are filing with a *state securities authority* that requires or permits advisers to submit Form ADV through the IARD.

Note: SEC rules require advisers that are registered or applying for registration with the SEC, or that are reporting to the SEC as an *exempt reporting adviser*, to file electronically through the IARD system. See SEC rules 203–1 and 204–4.

To file electronically, go to the IARD website (*www.iard.com*), which contains detailed instructions for advisers to follow when filing through the IARD.

Complete Form ADV (Paper Version) on paper if:
- You are filing with the SEC or a *state securities authority* that requires electronic filing, but you have been granted a continuing hardship exemption. Hardship exemptions are described in Instruction 17.
- You are filing with a *state securities authority* that permits (but does not require) electronic filing and you do not file electronically.

9. How do I get started filing electronically?

First, obtain a copy of the IARD Entitlement Package from the following website: http://www.iard.com/GetStarted.asp. Second, request access to the IARD system for your firm by completing and submitting the IARD Entitlement Package. The IARD Entitlement Package explains how the form may be submitted. Mail the forms to: FINRA Entitlement Group, 9509 Key West Avenue, Rockville, MD 20850.

When FINRA receives your Entitlement Package, they will assign a *CRD* number (identification number for your firm) and a user I.D. code and password (identification number and system password for the individual(s) who will submit Form ADV filings for your firm). Your firm may request an I.D. code and password for more than one individual. FINRA also will create a financial account for you from which the IARD will deduct filing fees and any state fees you are required to pay. If you already have a *CRD* account with FINRA, it will also serve as your IARD account; a separate account will not be established.

Once you receive your *CRD* number, user I.D. code and password, and you have funded your account, you are ready to file electronically.

Questions regarding the Entitlement Process should be addressed to FINRA at 240.386.4848.

10. If I am applying for registration with the SEC, or amending my SEC registration, how do I make *notice filings* with the *state securities authorities*?

If you are applying for registration with the SEC or are amending your SEC registration, one or more *state securities authorities* may require you to provide them with copies of your SEC filings. We call these filings ''*notice filings*.'' Your *notice filings* will be sent electronically to the states that you check on Item 2.C. of Part 1A. The *state securities authorities* to which you send *notice filings* may charge fees, which will be deducted from the account you establish with FINRA. To determine which *state securities authorities* require SEC-registered advisers to submit *notice filings* and to pay fees, consult the relevant state investment adviser law or *state securities authority*. See General Instruction 1.

If you are granted a continuing hardship exemption to file Form ADV on paper, FINRA will enter your filing into the IARD and your *notice filings* will be sent electronically to the *state securities authorities* that you check on Item 2.C. of Part 1A.

11. I am registered with a state. When must I switch to SEC registration?

If at the time of your *annual updating amendment* you meet at least one of the requirements for SEC registration in Item 2.A.(1) to (12) of Part 1A, you must apply for registration with the SEC within 90 days after you file the *annual updating amendment*. Once you register with the SEC, you are subject to SEC regulation, regardless of whether you remain registered with one or more states. See SEC rule 203A-1(b)(2). Each of your *investment adviser representatives*, however, may be subject to registration in those states in which the representative has a place of business. See Advisers Act section 203A(b)(1); SEC rule 203A-3(a). For additional information, consult the investment adviser laws or the *state securities authority* for the particular state in which you are ''doing business.'' See General Instruction 1.

12. I am registered with the SEC. When must I switch to registration with a *state securities authority*?

If you check box 13 in Item 2.A. of Part 1A to report on your *annual updating amendment* that you are no longer eligible to register with the SEC, you must withdraw from SEC registration within 180 days after the end of your fiscal year by filing Form ADV-W. See SEC rule 203A-1(b)(2). You should consult state law or the *state securities authority* for the states in which you are ''doing business'' to determine if you are required to register in these states. See General Instruction 1. Until you file your Form ADV-W with the SEC, you will remain subject to SEC regulation, and you also will be subject to regulation in any states where you register. See SEC rule 203A-1(b)(2).

13. I am an *exempt reporting adviser*. When must I submit my first report on Form ADV?

- *All exempt reporting advisers:*

  You must submit your initial Form ADV filing within 60 days of relying on the exemption from registration under either section 203(l) of the Advisers Act as an adviser solely to one or more venture capital funds or section 203(m) of the Advisers Act because you act solely as an adviser to private funds and have assets under management in the United States of less than $150 million.
- *Additional instruction for advisers switching from being registered to being exempt reporting advisers*:

  If you are currently registered as an investment adviser (or have an application for registration pending) with the SEC or with a *state securities authority*, you must file a Form ADV-W to withdraw from registration in the jurisdictions where you are switching. You must submit the Form ADV-W *before* submitting your first report as an *exempt reporting adviser*.

14. I am an *exempt reporting adviser*. Is it possible that I might be required to also register with or submit a report to a *state securities authority*?

Yes, you may be required to register with or submit a report to one or more *state securities authorities*. If you are required to register with one or more *state securities authorities*, you must complete all of Form ADV. See General Instruction 3. If you are required to submit a report to one or more *state securities authorities*, check the box(es) in Item 2.C. of Part 1A next to the state(s) you would like to receive the report. Each of your *investment adviser representatives* may also be subject to registration requirements. For additional information about the requirements that may apply to you, consult the investment adviser laws or the *state securities authority* for the particular state in which you are ''doing business.'' See General Instruction 1.

15. What do I do if I no longer meet the definition of ''*exempt reporting adviser*''?

- *Advisers Switching to SEC Registration*:
  - You may no longer be an *exempt reporting adviser* and may be required to

register with the SEC if you wish to continue doing business as an investment adviser. For example, you may be relying on section 203(l) and wish to accept a *client* that is not a venture capital fund as defined in SEC rule 203(l)-1, or you may have been relying on SEC rule 203(m)-1 and reported in Section 2.B. of Schedule D to your *annual updating amendment* that you have *private fund* assets of $150 million or more.

- If you are relying on section 203(l), unless you qualify for another exemption, you would violate the Advisers Act's registration requirement if you accept a *client* that is not a venture capital fund as defined in SEC rule 203(l)–1 before the SEC approves your application for registration. You must submit your final report as an *exempt reporting adviser* and apply for SEC registration in the same filing.
- If you were relying on SEC rule 203(m)–1 and you reported in Section 2.B. of Schedule D to your *annual updating amendment* that you have *private fund* assets of $150 million or more, you must register with the SEC unless you qualify for another exemption. If you have complied with all SEC reporting requirements applicable to an *exempt reporting adviser* as such, you have up to 90 days after filing your *annual updating amendment* to apply for SEC registration, and you may continue doing business as a *private fund* adviser during this time. You must submit your final report as an *exempt reporting adviser* and apply for SEC registration in the same filing. Unless you qualify for another exemption, you would violate the Advisers Act's registration requirement if you accept a *client* that is not a *private fund* during this transition period before the SEC approves your application for registration, and you must comply with all SEC reporting requirements applicable to an *exempt reporting adviser* as such during this 90-day transition period. If you have not complied with all SEC reporting requirements applicable to an *exempt reporting adviser* as such, this 90-day transition period is not available to you. Therefore, if the transition period is not available to you, and you do not qualify for another exemption, your application for registration must be approved by the SEC before you meet or exceed SEC rule 203(m)–1's $150 million asset threshold.
  - You will be deemed in compliance with the Form ADV *filing* and *reporting* requirements until the SEC approves or denies your application. If your application is approved, you will be able to continue business as a registered adviser.
  - If you register with the SEC, you may be subject to state *notice filing* requirements. To determine these requirements, consult the investment adviser laws or the *state securities authority* for the particular state in which you are ''doing business.'' See General Instruction 1.

Note: If you are relying on SEC rule 203(m)–1 and you accept a *client* that is not a *private fund*, you will lose the exemption provided by SEC rule 203(m)–1 immediately. To avoid this result, you should apply for SEC registration in advance so that the SEC has approved your registration *before* you accept a *client* that is not a *private fund*.

The 90-day transition period described above also applies to investment advisers with their *principal offices and places of business* outside of the United States with respect to their *clients* who are *United States persons* (*e.g.*, the adviser would not be eligible for the 90-day transition period if it accepted a *client* that is a *United States person* and is not a *private fund*).

- *Advisers Not Switching to SEC Registration*:
  - You may no longer be an *exempt reporting adviser* but may not be required to register with the SEC or may be prohibited from doing so. For example, you may cease to do business as an investment adviser, become eligible for an exemption that does not require reporting, or be ineligible for SEC registration. In this case, you must submit a final report as an *exempt reporting adviser* to update only Item 1 of Part 1A of Form ADV.
  - You may be subject to state registration requirements. To determine these requirements, consult the investment adviser laws or the *state securities authority* for the particular state in which you are ''doing business.'' See General Instruction 1.

16. Are there filing fees?

Yes. These fees go to support and maintain the IARD. The IARD filing fees are in addition to any registration or other fee that may be required by state law. You must pay an IARD filing fee for your initial application, your initial report, and each *annual updating amendment*. There is no filing fee for an other-than-annual amendment, a final report as an *exempt reporting adviser*, or Form ADV-W. The IARD filing fee schedule is published at http://www.sec.gov/iard; http://www.nasaa.org and http://www.iard.com.

If you are submitting a paper filing under a continuing hardship exemption (see Instruction 17), you are required to pay an additional fee. The amount of the additional fee depends on whether you are filing Form ADV or Form ADV–W. (There is no additional fee for filings made on Form ADV–W.) The hardship filing fee schedule is available by contacting FINRA at 240.386.4848.

17. What if I am not able to file electronically?

If you are required to file electronically but cannot do so, you may be eligible for one of two types of hardship exemptions from the electronic filing requirements.

- A temporary hardship exemption is available if you file electronically, but you encounter unexpected difficulties that prevent you from making a timely filing with the IARD, such as a computer malfunction or electrical outage. This exemption does *not* permit you to file on paper; instead it extends the deadline for an electronic filing for seven business days. See SEC rules 203–3(a) and 204–4(e).
- A continuing hardship exemption may be granted if you are a small business and you can demonstrate that filing electronically would impose an undue hardship. You are a small business, and may be eligible for a continuing hardship exemption, if you are required to answer Item 12 of Part 1A (because you have assets under management of less than $25 million) *and* you are able to respond ''no'' to each question in Item 12. See SEC rule 0–7.

If you have been granted a continuing hardship exemption, you must complete and submit the paper version of Form ADV to FINRA. FINRA will enter your responses into the IARD. As discussed in General Instruction 16, FINRA will charge you a fee to reimburse it for the expense of data entry.

18. I am eligible to file on paper. How do I make a paper filing?

When filing on paper, you must:

- Type all of your responses.
- Include your name (the same name you provide in response to Item 1.A. of Part 1A) and the date on every page.
- If you are amending your Form ADV:
  - complete page 1 and circle the number of any item for which you are changing your response.
  - include your SEC 801-number (if you have one), or your 802-number (if you have one), and your *CRD* number (if you have one) on every page.
  - complete the amended item in full and circle the number of the item for which you are changing your response.
  - to amend Schedule A or Schedule B, complete and submit Schedule C.

Where you submit your paper filing depends on why you are eligible to file on paper:

- If you are filing on paper because you have been granted a continuing hardship exemption, submit one manually signed Form ADV and one copy to: IARD Document Processing, FINRA, P.O. Box 9495, Gaithersburg, MD 20898-9495.

If you complete Form ADV on paper and submit it to FINRA but you do not have a continuing hardship exemption, the submission will be returned to you.

- If you are filing on paper because a state in which you are registered or in which you are applying for registration allows you to submit paper instead of electronic filings, submit one manually signed Form ADV and one copy to the appropriate *state securities authorities*.

19. Who is required to file Form ADV–NR?

Every *non-resident* general partner and *managing agent* of *all* SEC-registered advisers and *exempt reporting advisers*, whether or not the adviser is resident in the United States, must file Form ADV–NR in connection with the adviser's initial application or report. A general partner or *managing agent* of an SEC-registered adviser or *exempt reporting adviser* who becomes a *non-resident* after the adviser's initial application or report has been submitted must file Form ADV–NR within 30 days. Form ADV–NR must be filed on paper (it cannot be filed electronically).

Submit Form ADV–NR to the SEC at the following address:

Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549; Attn: OCIE Registrations Branch.

Failure to file Form ADV–NR promptly may delay SEC consideration of your initial application.

Federal Information Law and Requirements

Sections 203 and 204 of the Advisers Act [15 U.S.C. §§ 80b–3 and 80b–4] authorize the SEC to collect the information required by Form ADV. The SEC collects the information for regulatory purposes, such as deciding whether to grant registration. Filing Form ADV is mandatory for advisers who are required to register with the SEC and for *exempt reporting advisers*. The SEC maintains the information submitted on this form and makes it publicly available. The SEC may return forms that do not include required information. Intentional misstatements or omissions constitute federal criminal violations under 18 U.S.C. § 1001 and 15 U.S.C. § 80b–17.

SEC's Collection of Information

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Advisers Act authorizes the SEC to collect the information on Form ADV from investment advisers. See 15 U.S.C. §§ 80b–3 and 80b–4. Filing the form is mandatory.

The form enables the SEC to register investment advisers and to obtain information from and about *exempt reporting advisers*. Every applicant for registration with the SEC as an adviser, and every *exempt reporting adviser*, must file the form. See 17 C.F.R. §§ 275.203–1 and 204–4. By accepting a form, however, the SEC does not make a finding that it has been completed or submitted correctly. The form is filed annually by every adviser, no later than 90 days after the end of its fiscal year, to amend its registration or its report. It is also filed promptly during the year to reflect material changes. See 17 C.F.R. § 275.204–1. The SEC maintains the information on the form and makes it publicly available through the IARD.

Anyone may send the SEC comments on the accuracy of the burden estimate on page 1 of the form, as well as suggestions for reducing the burden. The Office of Management and Budget has reviewed this collection of information under 44 U.S.C. § 3507.

The information contained in the form is part of a system of records subject to the Privacy Act of 1974, as amended. The SEC has published in the **Federal Register** the Privacy Act System of Records Notice for these records.

[Form ADV, Part 3:][1] **Instructions to Form CRS**

General Instructions

Under rule 17a–14 under the Securities Exchange Act of 1934 and rule 204–5 under the Investment Advisers Act of 1940, broker-dealers registered under section 15 of the Exchange Act and investment advisers registered under section 203 of the Advisers Act are required to deliver to *retail investors* a *relationship summary* disclosing information about the firm. Read all the General Instructions as well as the particular item requirements before preparing or updating the *relationship summary*.

1. *Narrative and Graphical Format*.

a. The *relationship summary* must include the required items enumerated below. The items require you to provide specific information and, in some cases, prescribe the particular wording that you must use.

b. You must respond to each item and must provide responses in the same order as the items appear in these instructions. Unless otherwise noted, you must also present the required information within each item in the order listed.

c. Whether in electronic or paper format, the *relationship summary* must not exceed four 8½″ x 11″ pages if converted to PDF format, using at least an 11 point font size and a minimum 0.75'' margins on all sides.

d. You may not include disclosure in the *relationship summary* other than disclosure that is required or permitted by these Instructions and the applicable item.

e. If you are a *dual registrant*, present the information in Items 2 through 4 and Item 6 in a tabular format, comparing advisory services and brokerage services side-by-side. In the column discussing brokerage services, include the heading ''Broker-Dealer Services'' and the sub-heading ''Brokerage Accounts.'' In the column discussing investment advisory services, include the heading ''Investment Adviser Services'' and the sub-heading ''Advisory Accounts.'' *Dual registrants* should not complete Item 5, which must be completed by *standalone investment advisers and standalone broker-dealers*.

f. You may use charts, graphs, tables, and other graphics or text features to explain the required information, so long as the information: (i) is responsive to and meets the requirements in these instructions (including space limitations); (ii) is not inaccurate or misleading; and (iii) does not, because of the nature, quantity, or manner of presentation, obscure or impede understanding of the information that must be included. When using interactive graphics or tools, you may include instructions on their use and interpretation.

g. In a *relationship summary* that is posted on your website or otherwise provided electronically, you must use hyperlinks for any document that is cross-referenced in the *relationship summary* if the document is available online. See General Instruction 8.a. You may add embedded hyperlinks within the *relationship summary* in order to supplement required disclosures, for example, links to fee schedules, conflicts disclosures, the firm's narrative brochure required by Part 2A of Form ADV, or other regulatory disclosures.

2. *Plain Language*. The items of the *relationship summary* are designed to promote effective communication between you and *retail investors*. Write your *relationship summary* in plain language, taking into consideration *retail investors'* level of financial experience. The *relationship summary* should be concise and direct. In drafting the *relationship summary*: (i) use short sentences; (ii) use definite, concrete, everyday words; (iii) use active voice; (iv) avoid legal jargon or highly technical business terms unless you clearly explain them or you believe that reasonable *retail investors* will understand them; and (v) avoid multiple negatives. You must write the *relationship summary* as if you are speaking to the *retail investor*, using ''you,'' ''us,'' ''our firm,'' etc.

Note: The SEC's Office of Investor Education and Advocacy has published A Plain English Handbook. You may find the handbook helpful in writing your relationship summary. For a copy of this handbook, visit the SEC's website at *www.sec.gov/news/extra/handbook.htm* or call 1-800-732-0330.

3. *Full and Truthful Disclosure*. All information in your *relationship summary* must be true and may not omit any material facts necessary to make the disclosures required by these Instructions and the applicable item not misleading. If a statement is inapplicable to your business or would be misleading to a reasonable *retail investor*, you may omit or modify that statement.

Broker-dealers and investment advisers have disclosure and reporting obligations under state and federal law, including, but not limited to, obligations under the Exchange Act, the Advisers Act, and the respective rules thereunder. Broker-dealers are also subject to disclosure obligations under the rules of self-regulatory organizations. Delivery of this document will not necessarily satisfy the additional disclosure requirements that you have under the federal securities laws and regulations or other laws.

4. *Preserving Records*. You must maintain a copy of each version of the *relationship summary* and make it available to the SEC staff upon request. See SEC Advisers Act rule 204–2(a)(14)(i); SEC Exchange Act rule 17a–4.

5. *Initial Filing and Delivery; Transition Provisions*.

a. **Initial filing.** If you are a registered investment adviser and are required to give a *relationship summary* to a *retail investor*, you must complete Form ADV, Part 3 (Form CRS) and file it electronically in a text-searchable format with the Investment Adviser Registration Depository (IARD). If

[1] The bracketed text will be included for Form ADV, Part 3 (17 CFR 279.1) only.

you are a registered broker-dealer and are required to give a *relationship summary* to a *retail investor*, you must complete Form CRS and file it electronically in a text-searchable format with the Electronic Data Gathering, Analysis and Retrieval System (''EDGAR'').

If you do not have any *retail investors* to whom you must deliver a *relationship summary*, you are not required to prepare one.

Note to instruction 5(a): If you are a *dual registrant* and are required to give a *relationship summary* to one or more *retail investor* clients or customers of both your advisory and brokerage businesses, you must prepare only one *relationship summary* and file it on IARD and EDGAR.

Information for investment advisers on how to file with IARD is available on the Commission's website at *www.sec.gov/iard*. Information for broker-dealers on how to file with the Commission on EDGAR is available on the Commission's website at *https://www.sec.gov/edgar*.

b. **Initial delivery.** You must give a *relationship summary* to each *retail investor,* if you are an investment adviser, before or at the time you enter into an investment advisory agreement with the *retail investor,* or if you are a broker-dealer, before or at the time the *retail investor* first engages your services. See SEC Advisers Act rule 204-5(b)(1) and SEC Exchange Act rule 17a-14(c)(1). You must deliver the *relationship summary* even if your agreement with the *retail investor* is oral. A *dual registrant* should deliver the *relationship summary* at the earlier of entering into an investment advisory agreement with the *retail investor* or the *retail investor* engaging the firm's services.

c. Transition provisions for initial filing and delivery after the effective date of the new Form CRS requirements.

(i) If you are a broker-dealer, you must file your initial *relationship summary* with the Commission as required by instruction 5.a, by [INSERT DATE SIX MONTHS AFTER EFFECTIVE DATE OF RULES/FORM]. If you are an investment adviser or a *dual registrant*, you must amend your Form ADV by electronically filing with IARD your initial *relationship summary* as part of the next annual updating amendment you are required to file after [INSERT DATE SIX MONTHS AFTER EFFECTIVE DATE OF RULES/FORM].

(ii) As of the date by which you are first required to electronically file your *relationship summary* with the Commission, you must begin to deliver your *relationship summary* to new and prospective clients and customers who are *retail investors* as required by Instruction 5.b.

(iii) Within 30 days after the date by which you are first required to electronically file your *relationship summary* with the Commission, you must deliver your *relationship summary* to each of your existing clients and customers who are *retail investors*.

6. *Updating Relationship Summary*.

a. You must update your *relationship summary* within 30 days whenever any information in the *relationship summary* becomes materially inaccurate.

b. You must communicate any changes in the updated *relationship summary* to *retail investors* who are existing clients or customers of the firm within 30 days after the updates are required to be made and without charge. You can make the communication by delivering the amended *relationship summary* or by communicating the information in another way to the *retail investor*.

c. You must file each amended *relationship summary* electronically with the Commission, on IARD if you are an investment adviser or *dual registrant*, and on EDGAR if you are a broker-dealer.

7. *Additional Delivery Requirements to Existing Clients and Customers*.

a. You must deliver the *relationship summary* to a *retail investor* who is an existing client or customer before or at the time: (i) a new account is opened that is different from the *retail investor's* existing account(s); or (ii) changes are made to the *retail investor's* existing account(s) that would materially change the nature and scope of your relationship with the *retail investor*. For example, you must deliver a *relationship summary* before or at the time you recommend that the *retail investor* transfers from an investment advisory account to a brokerage account, transfers from a brokerage account to an investment advisory account, or moves assets from one type of account to another in a transaction not in the normal, customary or already agreed course of dealing. Whether a change would require delivery of the *relationship summary* would depend on the specific facts and circumstances.

b. You also must deliver the *relationship summary* to a *retail investor* within 30 days upon the *retail investor's* request.

8. *Electronic Posting and Manner of Delivery*.

a. You must post the current version of the *relationship summary* prominently on your public website, if you have one, in a location and format that is easily accessible for *retail investors*. If you do not have a public website, include in your *relationship summary* a toll-free number that *retail investors* may call to request documents.

b. You may deliver the *relationship summary* electronically, including updates, consistent with SEC guidance regarding electronic delivery of documents, in particular *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information*, which you can find at www.sec.gov/rules/concept/33-7288.txt.

c. If the relationship summary is delivered on paper and not as a standalone document, you should ensure that it is the first among any documents that are delivered at that time.

9. *Definitions*.

For purposes of this Form CRS, the following terms have the meanings ascribed to them below:

a. **Affiliate:** Any persons directly or indirectly controlling or controlled by you or under common control with you.

b. **Dual registrant:** A firm that is dually registered as a broker-dealer and an investment adviser and offers services to *retail investors* as both a broker-dealer and an investment adviser.

c. **Portfolio Manager:** An investment adviser that manages investments in a *wrap fee program*.

d. **Relationship summary:** A written disclosure statement that you must provide to *retail investors*. *See* Advisers Act rule 204-5; Exchange Act rule 17a-14; Form CRS.

e. **Retail investor:** A prospective or existing client or customer who is a natural person (an individual). This term includes a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust.

f. **Standalone investment adviser and standalone broker-dealer:** A *standalone investment adviser* is a registered investment adviser that offers services to *retail investors* and (i) is not dually registered as a broker-dealer or (ii) is dually registered as a broker-dealer but does not offer services to *retail investors* as a broker-dealer. A *standalone broker-dealer* is a registered broker-dealer that offers services to *retail investors* and (i) is not dually registered as an investment adviser or (ii) is dually registered as an investment adviser but does not offer services to *retail investors* as an investment adviser.

g. **Wrap fee program:** An advisory program under which a specified fee or fees not based directly upon transactions in a *retail investor's* account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of *retail investor* transactions.

[Form ADV, Part 3:] Form CRS

Item 1: Introduction

A. State your name, whether you are registered with the Securities and Exchange Commission as a broker-dealer, investment adviser, or both, and the date of the *relationship summary*. This information should be disclosed prominently on the first page, and can be included in the header or footer.

B. **Standalone Broker-Dealers:** If you are a *standalone broker-dealer*, include the title ''Is a Brokerage Account Right for You?'' Include the following introductory paragraphs (emphasis required):

''There are different ways you can get help with your investments. You should carefully consider which types of accounts and services are right for you.

We are a broker-dealer and provide brokerage accounts and services rather than advisory accounts and services. This document gives you a summary of the types of services we provide and how you pay. Please ask us for more information. There are some suggested questions on page [ ].''

C. **Standalone Investment Advisers:** If you are a *standalone investment adviser*, include the title ''Is an Investment Advisory Account Right for You?'' Include the following introductory paragraphs (emphasis required):

''There are different ways you can get help with your investments. You should carefully consider which types of accounts and services are right for you.

We are an investment adviser and provide advisory accounts and services rather than brokerage accounts and services. This document gives you a summary of the types of services we provide and how you pay. Please ask us for more information. There are some suggested questions on page [ ].''

D. **Dual Registrants:** If you are a *dual registrant*, include the title ''Which Type of Account is Right for You – Brokerage, Investment Advisory or Both?'' Include the following introductory paragraphs (emphasis required):

''There are different ways you can get help with your investments. You should carefully consider which types of accounts and services are right for you.

Depending on your needs and investment objectives, we can provide you with services in a brokerage account, investment advisory account, or both at the same time. This document gives you a summary of the types of services we provide and how you pay. Please ask us for more information. There are some suggested questions on page [ ].''

Item 2: Relationships and Services

A. Include the heading ''[Types of] Relationships and Services.'' If you are a *standalone broker-dealer* or *standalone investment adviser*, omit the bracketed language. If you are a *dual registrant*, include the bracketed language in the heading, and include the following after the heading: ''Our accounts and services fall into two categories.''

B. **Brokerage Account Services:** If you are a broker-dealer that offers brokerage accounts to *retail investors*, summarize the principal brokerage services that you provide to *retail investors*. You must address the following, unless not applicable:

1. Include the following (emphasis required): ''If you open a brokerage account, you will pay us a ***transaction-based fee***, generally referred to as a commission, every time you buy or sell an investment.''
2. If you offer accounts in which you offer recommendations to *retail investors*, state that the *retail investor* may select investments or you may recommend investments for the *retail investor's* account, but the *retail investor* will make the ultimate investment decision regarding the investment strategy and the purchase or sale of investments. If you only offer accounts in which you do not offer recommendations to *retail investors* (*e.g.,* execution-only brokerage services), state that the *retail investor* will select the investments and the *retail investor* will make the ultimate investment decision regarding the investment strategy and the purchase or sale of investments.
3. State if you offer to *retail investors* additional services, including, for example: (a) assistance with developing or executing the *retail investor's* investment strategy (*e.g.*, you discuss the *retail investor's* investment goals or you design with the *retail investor* a strategy to achieve the *retail investor's* investment goals), or (b) monitoring the performance of the *retail investor's* account. Indicate whether these services can be offered as additional services or are part of the standard brokerage account services, and whether a retail investor will pay more for these services. If you offer monitoring (as reflected in (b) above), as part of the standard brokerage account services, indicate how frequently you monitor the performance. Briefly describe any regular communications you have with *retail investors*, including the frequency and method of the communications.
4. If you significantly limit the types of investments available to *retail investors* in any accounts, include the following: ''We offer a limited selection of investments. Other firms could offer a wider range of choices, some of which might have lower costs.'' You significantly limit the types of investments if, for example, you only offer one type of asset (*e.g.*, mutual funds, exchange-traded funds, or variable annuities), you only offer mutual funds or other investments sponsored or managed by you or an affiliate (*i.e.*, proprietary products), or you only offer a small number of investments. If such limits only apply to certain accounts that you offer, identify those accounts.

C. **Investment Advisory Account Services:** If you are an investment adviser that offers investment advisory accounts to *retail investors*, summarize the principal investment advisory services that you provide to *retail investors*. You must address the following, unless not applicable:

1. State the type of fee you receive as compensation if the *retail investor* opens an investment advisory account. For example, state if you charge an on-going asset-based fee based on the value of cash and investments in the advisory account, a fixed fee, or some other fee arrangement. Emphasize the type of fee in bold and italicized font. If you are a *standalone adviser*, also state how frequently you assess the fee.
2. State that you offer advice on a regular basis, or, if you do not offer advice on a regular basis, state how frequently you offer advice. State the services you offer to *retail investors* including, for example, (a) assistance with developing the *retail investor's* investment strategy (*e.g.*, you discuss the *retail investor's* investment goals or you design with the *retail investor* a strategy to achieve the *retail investor's* investment goals); or (b) how frequently you monitor the *retail investor's* accounts. Briefly describe any regular communications you have with *retail investors*, including the frequency and method of the communications.
3. State if you offer advisory accounts for which you exercise discretion (*i.e.,* discretionary accounts), accounts where you do not exercise discretion (*i.e.*, non-discretionary accounts), or both. Emphasize the type of account (discretionary and non-discretionary) in bold and italicized font. If you offer a discretionary account, state that it allows you to buy and sell investments in the *retail investor's* account, without asking the *retail investor* in advance. If you offer a non-discretionary account, state that you give advice and the *retail investor* decides what investments to buy and sell.
4. If you significantly limit the types of investments available to *retail investors* in any accounts, include the following: ''Our investment advice will cover a limited selection of investments. Other firms could provide advice on a wider range of choices, some of which might have lower costs.'' You significantly limit the types of investments if, for example, you only offer one type of asset (*e.g.*, mutual funds, exchange-traded funds, or variable annuities), you only offer mutual funds or other investments sponsored or managed by you or an affiliate (*i.e.*, proprietary products), or you only offer a small number of investments. If such limits only apply to certain accounts that you offer, identify those accounts.

D. **Affiliate Services:** If you are a *standalone investment adviser or standalone broker-dealer* and have *affiliates* that offer to *retail investors* brokerage or advisory services, respectively, you may state that you provide *retail investors* with certain brokerage or advisory services of your *affiliates*, as applicable.

Item 3: Standard of Conduct

A. Include the heading ''Our Obligations to You'' and the following language after the heading: ''We must abide by certain laws and regulations in our interactions with you.''

B. **Broker-Dealers:** If you are a broker-dealer that offers brokerage accounts to *retail investors*, include the following:

1. ''[We must act in your best interest and not place our interests ahead of yours when we recommend an investment or an investment strategy involving securities.] When we provide any service to you, we must treat you fairly and comply with a number of specific obligations. Unless we agree otherwise, we are not required to monitor your portfolio or investments on an ongoing basis.'' Include the bracketed language only if you offer recommendations subject to Exchange Act Rule 15*l*-1 (''Regulation Best Interest'').
2. ''Our interests can conflict with your interests. [When we provide recommendations, we must eliminate these conflicts or tell you about them and in some cases reduce them].''

Include the bracketed language only if you offer recommendations subject to Regulation Best Interest.

C. **Investment Advisers:** If you are an investment adviser that offers investment advisory accounts to *retail investors*, include the following:

1. ''We are held to a fiduciary standard that covers our entire investment advisory relationship with you. [For example, we are required to monitor your portfolio, investment strategy and investments on an ongoing basis.]'' If you do not provide ongoing advice (for example, if you only provide a one-time financial plan), omit the bracketed sentence.
2. ''Our interests can conflict with your interests. We must eliminate these conflicts or tell you about them in a way you can understand, so that you can decide whether or not to agree to them.''

Item 4: Summary of Fees and Costs

A. Include the heading ''Fees and Costs'' and the following language after the heading: ''Fees and costs affect the value of your account over time. Please ask your financial professional to give you personalized information on the fees and costs that you will pay.''

B. **Brokerage Account Fees and Costs:** If you are a broker-dealer that offers brokerage accounts to *retail investors*, summarize the principal fees and costs that *retail investors* will incur.

1. If you are a *dual registrant* include the following (emphasis required): ''*Transaction-based fees.* You will pay us a fee every time you buy or sell an investment. This fee, commonly referred to as a commission, is based on the specific transaction and not the value of your account.'' If you are a *standalone broker-dealer* include the following: ''The fee you pay is based on the specific transaction and not the value of your account.''
2. Include the following (emphasis required):

(a) ''With stocks or exchange-traded funds, this fee is usually a separate commission. With other investments, such as bonds, this fee might be part of the price you pay for the investment (called a ''***mark-up***'' or ''***mark down***''). With mutual funds, this fee (typically called a ''***load***'') reduces the value of your investment.''

(b) State that some investments impose additional fees that will reduce the value of *retail investors'* investments over time and provide examples of such investments that you offer to *retail investors* (*e.g.*, mutual funds and variable annuities). Also state that a *retail investor* could be required to pay fees when certain investments are sold (*e.g.,* surrender charges for selling variable annuities).

3. State whether your fees vary and are negotiable, and describe the key factors that you believe would help a reasonable *retail investor* understand the fee that he or she is likely to pay for your services (*e.g.*, how much the *retail investor* buys or sells, what type of investment the *retail investor* buys or sells, and what kind of account the *retail investor* has with you).
4. State, if applicable, that a *retail investor* will also pay other fees in addition to the firm's principal fees. List other fees the *retail investor* will pay, including, but not limited to, custodian fees, account maintenance fees and account inactivity fees.
5. Include the following: ''The more transactions in your account, the more fees we charge you. We therefore have an incentive to encourage you to engage in transactions.''
6. If you are a *dual registrant* include the following: ''From a cost perspective, you may prefer a transaction-based fee if you do not trade often or if you plan to buy and hold investments for longer periods of time.''

C. **Investment Advisory Account Fees and Costs:** If you are an investment adviser that offers investment advisory accounts to *retail investors*, summarize the principal fees and costs that *retail investors* will incur. Your determination of the principal fees for investment advisory services should align with the type of fee(s) that you report in response to Form ADV Part 1A, Item 5.E. Include information about each type of fee you report that is responsive to this Item 4.C.

1. If you are a *dual registrant* include the following if you charge an asset-based fee (emphasis required): ''*Asset-based fees.* You will pay an on-going fee [at the end of each quarter] based on the value of the cash and investments in your advisory account.'' Replace the brackets with how frequently you assess the fee. If you charge another type of fee instead of an asset-based fee for your advisory services, briefly describe that fee and how frequently it is assessed.
2. Include the following: ''The amount paid to our firm and your financial professional generally does not vary based on the type of investments we select on your behalf. [The asset-based fee reduces the value of your account and will be deducted from your account.]'' Include the bracketed language if you charge an ongoing asset-based fee for your advisory accounts. If you charge another type of fee, succinctly describe how it is assessed and the impact it has on the value of the *retail investor's* account.
3. If you provide advice to *retail investors* about investing in a ***wrap fee program*** (and do not also offer ***retail investors*** another type of advisory account), include the following (emphasis required): ''We offer advisory accounts called ***wrap fee programs***. In a ***wrap fee program***, the asset-based fee will include most transaction costs and fees to a broker-dealer or bank that will hold your assets (called ''***custody***''), and as a result wrap fees are typically higher than non-wrap advisory fees.'' If you offer *retail investors* a *wrap fee program* as well as another type of advisory account, include the following (emphasis required): ''For some advisory accounts, called ***wrap fee programs***, the asset-based fee will include most transaction costs and custody services, and as a result wrap fees are typically higher than non-wrap advisory fees.''
4. State that some investments impose additional fees that will reduce the value of *retail investors'* investments over time and provide examples of such investments that you offer to *retail investors* (*e.g.*, mutual funds and variable annuities). Also state that a *retail investor* could be required to pay fees when certain investments are sold (*e.g.,* surrender charges for selling variable annuities).
5. State whether your fees vary and are negotiable, and describe the key factors that you believe would help a reasonable *retail investor* understand the fee that he or she is likely to pay for your services (*e.g.*, the services your receive and the amount of assets in your account).
6. State, if applicable, that a *retail investor* will pay transaction-based fees when you buy and sell an investment for the *retail investor* (*e.g.*, commissions paid to broker-dealers for buying or selling investments) in addition to the firm's principal fee it charges *retail investors* for the firm's advisory accounts. Also state, if applicable, that a *retail investor* will pay fees to a broker-dealer or bank that will hold the *retail investor's* assets and that this is called custody. List other fees the *retail investor* will pay, including, but not limited to, account maintenance services.
7. If you provide advice to *retail investors* about investing in a *wrap fee program*, include the following: ''Although transaction fees are usually included in the wrap program fee, sometimes you will pay an additional transaction fee (for investments bought and sold outside the wrap fee program).''
8. If you charge an ongoing asset-based fee, include the following: ''The more assets you have in the advisory account, including cash, the more you will pay us. We therefore have an incentive to increase the assets in your account in order to increase our fees. You pay our fee [insert frequency of fee (*e.g.,* quarterly)] even if you do not buy or sell.'' Replace the brackets with the frequency of your fee.
9. If you provide advice to *retail investors* about investing in a *wrap fee program*, also include the following: ''Paying for a wrap fee program could cost more than separately paying for advice and for transactions if there are infrequent trades in your account.''
10. If you are a *dual registrant* that charges an ongoing asset-based fee, include the following: ''An asset-based fee may cost more than a transaction-based fee, but you may prefer an asset-based fee if you want continuing advice or want someone to make investment decisions for you.'' If you provide advice to *retail investors* about investing in a *wrap fee program*, also include the following: ''You may prefer a *wrap fee program* if you prefer the certainty of a [insert frequency of the wrap fee (*e.g.,* quarterly)] fee regardless

of the number of transactions you have.'' Replace the brackets with the frequency of the wrap fee.

Item 5: Comparisons to be provided by *standalone investment advisers and standalone broker-dealers*

A. If you are a *standalone investment adviser*, include the heading ''Compare with Typical Brokerage Accounts,'' and include the following under the heading (emphasis required): ''You could also open a brokerage account with a ***broker-dealer***, where you will pay a ***transaction-based fee,*** generally referred to as a commission, when the broker-dealer buys or sells an investment for you.'' Include ''Features of a typical brokerage account include:'' and then include the following statements, each set off by a bullet point (except as specified below), in the following order:

1. ''With a broker-dealer, you may select investments or the broker-dealer may recommend investments for your account, but the ultimate decision for your investment strategy and the purchase and sale of investments will be yours.''
2. ''A broker-dealer must act in your best interest and not place its interests ahead of yours when the broker-dealer recommends an investment or an investment strategy involving securities. When a broker-dealer provides any service to you, the broker-dealer must treat you fairly and comply with a number of specific obligations. Unless you and the broker-dealer agree otherwise, the broker-dealer is not required to monitor your portfolio or investments on an ongoing basis.''
3. ''If you were to pay a transaction-based fee in a brokerage account, the more trades in your account, the more fees the broker-dealer charges you. So it has an incentive to encourage you to trade often.''
4. Include ''You can receive advice in either type of account, but you may prefer paying:'' and then present the following information in this sub-item in a tabular format, comparing a transaction-based fee and an asset-based fee side-by-side. In one column, include the following (emphasis required): ''***a transaction-based fee*** from a cost perspective, if you do not trade often or if you plan to buy and hold investments for longer periods of time.'' In the other column, include the following (emphasis required): ''***an asset-based fee*** if you want continuing advice or want someone to make investment decisions for you, even though it may cost more than a transaction-based fee.''

B. If you are a standalone *broker-dealer*, include the heading ''Compare with Typical Advisory Accounts,'' and include the following under the heading (emphasis required): ''You could also open an advisory account with an ***investment adviser***, where you will pay an ongoing ***asset-based fee*** that is based on the value of the cash and investments in your advisory account.'' Include ''Features of a typical advisory account include:'' and then include the following statements, each set off by a bullet point (except as specified below), in the following order (emphasis required):

1. ''Advisers provide advice on a regular basis. They discuss your investment goals, design with you a strategy to achieve your investment goals, and regularly monitor your account.''
2. ''You can choose an account that allows the adviser to buy and sell investments in your account without asking you in advance (a ''***discretionary account***'') or the adviser may give you advice and you decide what investments to buy and sell (a ''***non-discretionary account***'').''
3. ''Advisers are held to a fiduciary standard that covers the entire investment advisory relationship. For example, advisers are required to monitor your portfolio, investment strategy and investments on an ongoing basis.''
4. ''If you were to pay an asset-based fee in an advisory account, you would pay the fee periodically, even if you do not buy or sell. You may also choose to work with an investment adviser who provides investment advice for an hourly fee, or provides a financial plan for a one-time fee.''
5. ''For an adviser that charges an asset-based fee, the more assets you have in an advisory account, including cash, the more you will pay the adviser. So the adviser has an incentive to increase the assets in your account in order to increase its fees.''
6. Include ''You can receive advice in either type of account, but you may prefer paying:'' and then present the following information in this sub-item in a tabular format, comparing a transaction-based fee and an asset-based fee side-by-side. In one column, include the following (emphasis required): ''***an asset-based fee*** if you want continuing advice or want someone to make investment decisions for you, even though it may cost more than a transaction-based fee.'' In the other column, include the following (emphasis required): ''***a transaction-based fee*** from a cost perspective if you do not trade often or if you plan to buy and hold investments for longer periods of time.''

Item 6. Conflicts of Interest

A. Include the heading, ''Conflicts of Interest.'' *Standalone broker-dealers* must include the following after the heading: ''We benefit from our recommendations to you.'' *Standalone investment advisers* must include the following after the heading: ''We benefit from the advisory services we provide to you.'' *Dual registrants* must include the following after the heading: ''We benefit from the services we provide to you.''

B. Briefly describe the following conflicts of interest, as they are applicable to you. If all or a portion of a conflict is inapplicable to your business, omit that conflict or portion thereof. If you are a *dual registrant* and a conflict only applies to your brokerage accounts or to your investment advisory accounts, only include that conflict in the applicable column.

1. State that you have a financial incentive to offer or recommend the *retail investor* to invest in certain investments because (a) they are issued, sponsored or managed by you or your affiliates, (b) third parties compensate you when you recommend or sell the investments, or (c) both. Provide examples of such investments. State that your financial professionals receive additional compensation if the *retail investor* buys these investments.
2. State that you have an incentive to offer or recommend the *retail investor* to invest in certain investments because the manager or sponsor of those investments or another third party (such as an intermediary) shares with you revenue it earns on those investments. Provide examples of such investments.
3. State that you can buy investments from a *retail investor*, and sell investments to a *retail investor*, from your own accounts (called ''acting as principal''). State that you can earn a profit on these trades, and that you have an incentive to encourage the *retail investor* to trade with you. If this activity is part of your investment advisory business, state that the *retail investor's* specific approval on each such transaction is required.

Item 7. Additional Information.

A. Include the heading, ''Additional Information'' and include the following after the heading: ''We encourage you to seek out additional information.''

B. Include the following: ''We have legal and disciplinary events'' if you or one of your financial professionals currently disclose, or are required to disclose, the following information:

1. Disciplinary information in your Form ADV (Item 11 of Part 1A or Item 9 of Part 2A).
2. Legal or disciplinary events in your Form BD (Items 11 A-K) (except to the extent such information is not released to BrokerCheck, pursuant to FINRA Rule 8312).
3. Disclosures for any of your financial professionals in Items 14 A-M on Form U4 (Uniform Application for Securities Industry Registration or Transfer), or in Items 7(a) and 7(c)-(f) of Form U5 (Uniform Termination Notice for Securities Industry Registration) or on Form U6 (Uniform Disciplinary Action Reporting Form) (except to the extent such information is not released to BrokerCheck, pursuant to FINRA Rule 8312).

C. Regardless of your response to Item 7.B, you must state the following: ''Visit Investor.gov for a free and simple search tool to research our firm and our financial professionals.''

D. Include the following: ''To report a problem to the SEC, visit Investor.gov or call the SEC's toll-free investor assistance line at (800) 732-0330. [To report a problem to FINRA, [ ].] If you have a problem with your investments, investment account or a financial professional, contact us in writing at [insert your primary business address].'' If you are a broker-dealer or *dual registrant*, include the bracketed language. It is your responsibility to review the current telephone numbers for the SEC and FINRA no less often than annually and update as necessary.

E. State where the *retail investor* can find additional information about your brokerage and investment advisory services.

1. If you are a broker-dealer, state that for additional information about your brokers and services, visit BrokerCheck, your website, and the *retail investor's* account agreement. Include a link to the portion of your website that provides up-to-date information for *retail investors* and the following link to BrokerCheck: Brokercheck.Finra.org. If you do not have a public firm website, then you must include a toll-free telephone number where *retail investors* can request up-to-date information.
2. If you are an investment adviser, state that for additional information on your investment advisory services, see your Form ADV brochure on IAPD on Investor.gov and any brochure supplement a financial professional provides. If you maintain your current Form ADV brochure on your public website, then you must state the website address. If you do not have a public firm website or if you do not maintain your current Form ADV brochure on your public website, then you must include the following link: adviserinfo.sec.gov. If you do not have a public firm website, then you also must include a toll-free telephone number where *retail investors* can request up-to-date information.

Item 8. Key Questions to Ask.

Under the heading ''Key Questions to Ask,'' include the key questions below and the following: ''Ask our financial professionals these key questions about our investment services and accounts.''

Use formatting to make the questions more noticeable and prominent (for example, by using larger font, a text box around the heading or questions, different font, or lines to offset the questions from the other sections). You may modify or omit portions of any questions that you determine are inapplicable to your business. If you are a *standalone broker-dealer* or *standalone investment adviser*, you should modify the questions below to reflect the type of account you offer to *retail investors* (*e.g.*, advisory or brokerage account).

Advisers that provide automated advice or broker-dealers that provide services only online without a particular individual with whom a *retail investor* can discuss these questions must include a section or page on their website that answers each of the below questions and should provide a hyperlink in the *relationship summary* to that section or page. If you provide automated advice but make a financial professional available to discuss the existing account with a *retail investor*, you may wish to consider making the financial professional available to discuss these questions with the *retail investor*.

1. Given my financial situation, why should I choose an advisory account? Why should I choose a brokerage account?
2. Do the math for me. How much would I pay per year for an advisory account? How much for a typical brokerage account? What would make those fees more or less? What services will I receive for those fees?
3. What additional costs should I expect in connection with my account?
4. Tell me how you and your firm make money in connection with my account. Do you or your firm receive any payments from anyone besides me in connection with my investments?
5. What are the most common conflicts of interest in your advisory and brokerage accounts? Explain how you will address those conflicts when providing services to my account.
6. How will you choose investments to recommend for my account?
7. How often will you monitor my account's performance and offer investment advice?
8. Do you or your firm have a disciplinary history? For what type of conduct?
9. What is your relevant experience, including your licenses, education and other qualifications? Please explain what the abbreviations in your licenses are and what they mean.
10. Who is the primary contact person for my account, and is he or she a representative of an investment adviser or a broker-dealer? What can you tell me about his or her legal obligations to me? If I have concerns about how this person is treating me, who can I talk to?

In addition to the abovementioned questions, you may also include any other frequently asked questions you receive following these questions. You may not, however, exceed fourteen questions in total.

Appendix C

Hypothetical Relationship Summary for a Dually Registered Investment Adviser and Broker-Dealer Prepared By SEC Staff—For Illustrative Purposes Only

Which Type of Account is Right for You—Brokerage, Investment Advisory or Both?

There are different ways you can get help with your investments. You should carefully consider which types of accounts and services are right for you.

Depending on your needs and investment objectives, we can provide you with services in a brokerage account, investment advisory account, or both at the same time. This document gives you a summary of the types of services we provide and how you pay. Please ask us for more information. There are some suggested questions on page 4.

BILLING CODE 8011–01–P

Broker-Dealer Services **Brokerage Accounts**	*Investment Adviser Services* **Advisory Accounts**
Types of Relationships and Services. *Our accounts and services fall into two categories.*	
• If you open a brokerage account, you will pay us a ***transaction-based fee***, generally referred to as a commission, every time you buy or sell an investment. • You may select investments or we may recommend investments for your account, but the ultimate investment decision for your investment strategy and the purchase or sale of investments will be yours. • We can offer you additional services to assist you in developing and executing your investment strategy and monitoring the performance of your account but you might pay more. We will deliver account statements to you each quarter in paper or electronically. • We offer a limited selection of investments. Other firms could offer a wider range of choices, some of which might have lower costs.	• If you open an advisory account, you will pay an on-going ***asset-based fee*** for our services. • We will offer you advice on a regular basis. We will discuss your investment goals design with you a strategy to achieve your investment goals, and regularly monitor your account. We will contact you (by phone or e-mail) at least quarterly to discuss your portfolio. • You can choose an account that allows us to buy and sell investments in your account without asking you in advance (a "***discretionary account***") or we may give you advice and you decide what investments to buy and sell (a "***non-discretionary account***"). • Our investment advice will cover a limited selection of investments. Other firms could provide advice on a wider range of choices, some of which might have lower costs.
Our Obligations to You. *We must abide by certain laws and regulations in our interactions with you.*	
• We must act in your best interest and not place our interests ahead of yours when we recommend an investment or an investment strategy involving securities. When we provide any service to you, we must treat you fairly and comply with a number of specific obligations. Unless we agree otherwise, we are not required to monitor your portfolio or investments on an ongoing basis. • Our interests can conflict with your interests. When we provide recommendations, we must eliminate these conflicts or tell you about them and in some cases reduce them.	• We are held to a fiduciary standard that covers our entire investment advisory relationship with you. For example, we are required to monitor your portfolio, investment strategy and investments on an ongoing basis. • Our interests can conflict with your interests. We must eliminate these conflicts or tell you about them in a way you can understand, so that you can decide whether or not to agree to them.
Fees and Costs. *Fees and costs affect the value of your account over time. Please ask your financial*	

- SAMPLE FIRM, broker-dealer and investment adviser registered with the Securities and Exchange Commission, April 1, 2018 -

Broker-Dealer Services **Brokerage Accounts**	*Investment Adviser Services* **Advisory Accounts**
professional to give you personalized information on the fees and costs that you will pay.	
• *Transaction-based fees*. You will pay us a fee every time you buy or sell an investment. This fee, commonly referred to as a commission, is based on the specific transaction and not the value of your account. With stocks or exchange-traded funds, this fee is usually a separate commission. With other investments, such as bonds, this fee might be part of the price you pay for the investment (called a "***mark-up***" or "***mark down***"). With mutual funds, this fee (typically called a "***load***") reduces the value of your investment. • Some investments (such as mutual funds and variable annuities) impose additional fees that will reduce the value of your investment over time. Also, with certain investments such as variable annuities, you may have to pay fees such as "***surrender charges***" to sell the investment. • Our fees vary and are negotiable. The amount you pay will depend, for example, on how much you buy or sell, what type of investment you buy or sell, and what kind of account you have with us. • We charge you additional fees, such as custodian fees, account maintenance fees, and account inactivity fees. • The more transactions in your account, the more fees we charge you. We therefore have an incentive to encourage you to engage in transactions. • From a cost perspective, you may prefer a transaction-based fee if you do not trade often or if you plan to buy and hold	• *Asset-based fees*. You will pay an on-going fee at the end of each quarter based on the value of the cash and investments in your advisory account. The amount paid to our firm and your financial professional generally does not vary based on the type of investments we select on your behalf. The asset-based fee reduces the value of your account and will be deducted from your account. For some advisory accounts, called ***wrap fee programs***, the asset-based fee will include most transaction costs and custody services, and as a result wrap fees are typically higher than non-wrap advisory fees. • Some investments (such as mutual funds and variable annuities) impose additional fees that will reduce the value of your investment over time. Also, with certain investments such as variable annuities, you may have to pay fees such as "***surrender charges***" to sell the investment. • Our fees vary and are negotiable. The amount you pay will depend, for example, on the services you receive and the amount of assets in your account. • For accounts not part of the wrap fee program, you will pay a transaction fee when we buy and sell an investment for you. You will also pay fees to a broker-dealer or bank that will hold your assets (called "***custody***"). Although transaction fees are usually included in the wrap program fee, sometimes you will pay an additional transaction fee (for investments bought and sold outside the wrap fee program). • The more assets you have in the advisory

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<table>
<tr><th>Broker-Dealer Services
Brokerage Accounts</th><th>Investment Adviser Services
Advisory Accounts</th></tr>
<tr><td>investments for longer periods of time.</td><td>account, including cash, the more you will pay us. We therefore have an incentive to increase the assets in your account in order to increase our fees. You pay our fee quarterly even if you do not buy or sell.
• Paying for a wrap fee program could cost more than separately paying for advice and for transactions if there are infrequent trades in your account.
• An asset-based fee may cost more than a transaction-based fee, but you may prefer an asset-based fee if you want continuing advice or want someone to make investment decisions for you. You may prefer a wrap fee program if you prefer the certainty of a quarterly fee regardless of the number of transactions you have.</td></tr>
<tr><td colspan="2">Conflicts of Interest. We benefit from the services we provide to you.</td></tr>
<tr><td>• We can make extra money by selling you certain investments, such as [__], either because they are managed by someone related to our firm or because they are offered by companies that pay our firm to offer their investments. Your financial professional also receives more money if you buy these investments.
• We have an incentive to offer or recommend certain investments, such as [_], because the manager or sponsor of those investments shares with us revenue it earns on those investments.
• We can buy investments from you, and sell investments to you, from our own accounts (called “acting as principal”). We can earn a profit on these trades, so we have an incentive to encourage you to trade with us.</td><td>• We can make extra money by advising you to invest in certain investments, such as [__], because they are managed by someone related to our firm. Your financial professional also receives more money if you buy these investments.
• We have an incentive to advise you to invest in certain investments, such as [_], because the manager or sponsor of those investments shares with us revenue it earns on those investments.
• We can buy investments from you, and sell investments to you, from our own accounts (called “acting as principal”), but only with your specific approval on each transaction. We can earn a profit on these trades, so we have an incentive to encourage you to trade with us.</td></tr>
<tr><td colspan="2">Additional Information. We encourage you to seek out additional information.</td></tr>
<tr><td colspan="2">• We have legal and disciplinary events. Visit Investor.gov for a free and simple search tool to</td></tr>
</table>

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Broker-Dealer Services **Brokerage Accounts**	***Investment Adviser Services*** **Advisory Accounts**

research our firm and our financial professionals.

- For additional information about our brokers and services, visit Investor.gov or BrokerCheck (BrokerCheck.Finra.org), our website (SampleFirm.com), and your account agreement. For additional information on advisory services, see our Form ADV brochure on IAPD, on Investor.gov, or on our website (SAMPLEFirm.com/FormADV) and any brochure supplement your financial professional provides.
- To report a problem to the SEC, visit Investor.gov or call the SEC's toll-free investor assistance line at (800) 732-0330. To report a problem to FINRA, [ ]. If you have a problem with your investments, account or financial professional, contact us in writing at [ ].

Key Questions to Ask. *Ask our financial professionals these key questions about our investment services and accounts.*

1. Given my financial situation, why should I choose an advisory account? Why should I choose a brokerage account?
2. Do the math for me. How much would I expect to pay per year for an advisory account? How much for a typical brokerage account? What would make those fees more or less? What services will I receive for those fees?
3. What additional costs should I expect in connection with my account?
4. Tell me how you and your firm make money in connection with my account. Do you or your firm receive any payments from anyone besides me in connection with my investments?
5. What are the most common conflicts of interest in your advisory and brokerage accounts? Explain how you will address those conflicts when providing services to my account.
6. How will you choose investments to recommend for my account?
7. How often will you monitor my account's performance and offer investment advice?
8. Do you or your firm have a disciplinary history? For what type of conduct?
9. What is your relevant experience, including your licenses, education, and other qualifications? Please explain what the abbreviations in your licenses are and what they mean.
10. Who is the primary contact person for my account, and is he or she a representative of an investment adviser or a broker-dealer? What can you tell me about his or her legal obligations to me? If I have concerns about how this person is treating me, who can I talk to?

- SAMPLE FIRM, broker-dealer and investment adviser registered with the Securities and Exchange Commission, April 1, 2018 -

Appendix D

Hypothetical Relationship Summary for a Registered Broker-Dealer Prepared By SEC Staff—For Illustrative Purposes Only

Is A Brokerage Account Right For You?

There are different ways you can get help with your investments. You should carefully consider which types of accounts and services are right for you.

We are a broker-dealer and provide brokerage accounts and services rather than advisory accounts and services. This document gives you a summary of the types of services we provide and how you pay. Please ask us for more information. There are some suggested questions on page 4.

Relationships and Services.

- If you open a brokerage account, you will pay us a ***transaction-based fee,*** generally referred to as a commission, every time you buy or sell an investment.
- You may select investments or we may recommend investments for your account, but the ultimate investment decision as to your investment strategy and the purchase or sale of investments will be yours.
- We can offer you additional services to assist you in developing and executing your investment strategy and monitoring the performance of your account but you might pay more. We will deliver account statements to you each quarter in paper or electronically.
- We offer a limited selection of investments. Other firms could offer a wider range of choices, some of which might have lower costs.

Our Obligations to You. *We must abide by certain laws and regulations in our interactions with you.*

- We must act in your best interest and not place our interests ahead of yours when we recommend an investment or an investment strategy involving securities. When we provide any service to you, we must treat you fairly and comply with a number of specific obligations. Unless we agree otherwise, we are not required to monitor your portfolio or investments on an ongoing basis.
- Our interests can conflict with your interests. When we provide recommendations, we must eliminate these conflicts or tell you about them and in some cases reduce them.

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April 1, 2018 -

Fees and Costs. *Fees and costs affect the value of your account over time. Please ask your financial professional to give you personalized information on the fees and costs that you will pay.*

- The fee you pay is based on the specific transaction and not the value of your account.

- With stocks or exchange-traded funds, this fee is usually a separate commission. With other investments, such as bonds, this fee might be part of the price you pay for the investment (called a "***mark-up***" or "***mark down***"). With mutual funds, this fee (typically called a "***load***") reduces the value of your investment.

- Some investments (such as mutual funds and variable annuities) impose additional fees that will reduce the value of your investment over time. Also, with certain investments such as variable annuities, you may have to pay fees such as "***surrender charges***" to sell the investment.

- Our fees vary and are negotiable. The amount you pay will depend, for example, on how much you buy or sell, what type of investment you buy or sell, and what kind of account you have with us.

- We charge you additional fees, such as custodian fees, account maintenance fees, and account inactivity fees.

- The more transactions in your account, the more fees we charge you. We therefore have an incentive to encourage you to engage in transactions.

Compare with Typical Advisory Accounts.

You could also open an advisory account with an ***investment adviser***, where you will pay an ongoing ***asset-based fee*** that is based on the value of the cash and investments in your advisory account. Features of a typical advisory account include:

- Advisers provide advice on a regular basis. They discuss your investment goals, design with you a strategy to achieve your investment goals, and regularly monitor your account.

- You can choose an account that allows the adviser to buy and sell investments in your account without asking you in advance (a "***discretionary account***") or the adviser may give you advice and you decide what investments to buy and sell (a "***non-discretionary account***").

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- Advisers are held to a fiduciary standard that covers the entire investment advisory relationship. For example, advisers are required to monitor your portfolio, investment strategy and investments on an ongoing basis.

- If you were to pay an asset-based fee in an advisory account, you would pay the fee periodically even if you do not buy or sell. You may also choose to work with an investment adviser who provides investment advice for an hourly fee, or provides a financial plan for a one-time fee.

- For an adviser that charges an asset-based fee, the more assets you have in an advisory account, including cash, the more you will pay the adviser. So the adviser has an incentive to increase the assets in your account in order to increase its fees.

- You can receive advice in either type of account, but you may prefer paying:

an asset-based fee if you want continuing advice or want someone to make investment decisions for you, even though it may cost more than a transaction-based fee.	***a transaction-based fee*** from a cost perspective, if you do not trade often or if you plan to buy and hold investments for longer periods of time.

Conflicts of Interest. *We benefit from our recommendations to you.*

- We can make extra money by selling you certain investments, such as [__], either because they are managed by someone related to our firm or because they are offered by companies that pay our firm to sell their investments. Your financial professional also receives more money if you buy these investments.

- We have an incentive to offer or recommend certain investments, such as [__], because the manager or sponsor of those investments shares with us revenue it earns on those investments.

- We can buy investments from you, and sell investments to you, from our own accounts (called "***acting as principal***"). We can earn a profit on these trades, so we have an incentive to encourage you to trade with us.

Additional Information. *We encourage you to seek additional information.*

- We have legal and disciplinary events. Visit Investor.gov for a free and simple search tool to research our firm and our financial professionals.

- SAMPLE FIRM, an investment adviser registered with the Securities and Exchange Commission, April 1, 2018 -

- For additional information about our brokers and services, visit Investor.gov, BrokerCheck (BrokerCheck.Finra.org), our web site (SampleFirm.com), and your account agreement.

- To report a problem to the SEC, visit Investor.gov or call the SEC's toll-free investor assistance line at (800) 732-0330. To report a problem to FINRA, [ ]. If you have a problem with your investments, account or financial professional, contact us in writing at [ ].

Key Questions to Ask. *Ask our financial professionals these key questions about our investment services and accounts.*

1. Given my financial situation, why should I choose a brokerage account?
2. Do the math for me. How much would I pay per year for a typical brokerage account? What would make those fees more or less? What services will I receive for those fees?
3. What additional costs should I expect in connection with my account?
4. Tell me how you and your firm make money in connection with my account. Do you or your firm receive any payments from anyone besides me in connection with my investments?
5. What are the most common conflicts of interest in your brokerage accounts? Explain how you will address those conflicts when providing services to my account.
6. How will you choose investments to recommend for my account?
7. How often will you monitor my account's performance and offer investment advice?
8. Do you or your firm have a disciplinary history? For what type of conduct?
9. What is your relevant experience, including your licenses, education, and other qualifications? Please explain what the abbreviations in your licenses are and what they mean.
10. Who is the primary contact person for my account? What can you tell me about his or her legal obligations to me? If I have concerns about how this person is treating me, who can I talk to?

- SAMPLE FIRM, an investment adviser registered with the Securities and Exchange Commission, April 1, 2018 -

Appendix E

Hypothetical Relationship Summary for a Registered Investment Adviser Prepared By SEC Staff—For Illustrative Purposes Only

Is An Investment Advisory Account Right For You?

There are different ways you can get help with your investments. You should carefully consider which types of accounts and services are right for you.

We are an investment adviser and provide advisory accounts and services rather than brokerage accounts and services. This document gives you a summary of the types of services we provide and how you pay. Please ask us for more information. There are some suggested questions on page 3.

Relationships and Services.

- If you open an advisory account, you will pay an on-going ***asset-based fee*** at the end of each quarter for our services, based on the value of the cash and investments in your advisory account.

- We will offer you advice on a regular basis. We will discuss your investment goals, design with you a strategy to achieve your investment goals, and regularly monitor your account. We will contact you (by phone or e-mail) at least quarterly to discuss your portfolio.

- You can choose an account that allows us to buy and sell investments in your account without asking you in advance (a "***discretionary account***") or we may give you advice and you decide what investments to buy and sell (a "***non-discretionary account***").

- Our investment advice will cover a limited selection of investments. Other firms could provide advice on a wider range of choices, some of which might have lower costs.

Our Obligations to You. *We must abide by certain laws and regulations in our interactions with you.*

- We are held to a fiduciary standard that covers our entire investment advisory relationship with you. For example, we are required to monitor your portfolio, investment strategy, and investments on an ongoing basis.

- Our interests can conflict with your interests. We must eliminate these conflicts or tell you about them in a way you can understand, so that you can decide whether or not to agree to them.

- SAMPLE FIRM, an investment adviser registered with the Securities and Exchange Commission, April 1, 2018 -

Fees and Costs. *Fees and costs affect the value of your account over time. Please ask your financial professional to give you personalized information on the fees and costs that you will pay.*

- The amount paid to our firm and your financial professional generally does not vary based on the type of investments we select on your behalf. The asset-based fee reduces the value of your account and will be deducted from your account.
- Some investments (such as mutual funds and variable annuities) impose additional fees that will reduce the value of your investment over time. Also, with certain investments such as variable annuities, you may have to pay fees such as "***surrender charges***" to sell the investment.
- Our fees vary and are negotiable. The amount you pay will depend, for example, on the services you receive and the amount of assets in your account.
- You will pay a transaction fee when we buy and sell an investment for you. You will also pay fees to a broker-dealer or bank that will hold your assets (called "***custody***").
- The more assets you have in the advisory account, including cash, the more you will pay us. We therefore have an incentive to increase the assets in your account in order to increase our fees. You pay our fee quarterly even if you do not buy or sell.

Compare with Typical Brokerage Accounts.

You could also open a brokerage account with a ***broker-dealer***, where you will pay a ***transaction-based fee,*** generally referred to as a commission, when the broker-dealer buys or sells an investment for you. Features of a typical brokerage account include:

- With a broker-dealer, you may select investments or the broker-dealer may recommend investments for your account, but the ultimate decision for your investment strategy and the purchase and sale of investments will be yours.
- A broker-dealer must act in your best interest and not place its interests ahead of yours when the broker-dealer recommends an investment or an investment strategy involving securities. When a broker-dealer provides any service to you, the broker-dealer must treat you fairly and comply with a number of specific obligations. Unless you and the broker-dealer agree otherwise, the broker-dealer is not required to monitor your portfolio or investments on an ongoing basis.
- If you were to pay a transaction-based fee in a brokerage account, the more trades in your account, the more fees the broker-dealer charges you. So it has an incentive to encourage you to trade often.

- SAMPLE FIRM, an investment adviser registered with the Securities and Exchange Commission, April 1, 2018 -

- You can receive advice in either type of account, but you may prefer paying:

a transaction-based fee from a cost perspective, if you do not trade often or if you plan to buy and hold investments for longer periods of time.	***an asset-based fee*** if you want continuing advice or want someone to make investment decisions for you, even though it may cost more than a transaction-based fee.

Conflicts of Interest. *We benefit from the advisory services we provide to you.*

- We can make extra money by advising you to invest in certain investments, such as [__], because they are managed by someone related to our firm. Your financial professional also receives more money if you buy these investments.

- We have an incentive to advise you to invest in certain investments, such as [_], because the manager or sponsor of those investments shares with us revenue it earns on those investments.

- We can buy investments from you, and sell investments to you, from our own accounts (called "***acting as principal***"), ***but only with your specific approval on each transaction.*** We can earn a profit on these trades, so we have an incentive to encourage you to trade with us.

Additional Information. *We encourage you to seek additional information.*

- We have legal and disciplinary events. Visit Investor.gov for a free and simple search tool to research our firm and our financial professionals.

- For additional information on our advisory services, see our Form ADV brochure on IAPD on Investor.gov or on our website (SampleFirm.com/FormADV) and any brochure supplement your financial professional provides.

- To report a problem to the SEC, visit Investor.gov or call the SEC's toll-free investor assistance line at (800) 732-0330. If you have a problem with your investments, account or financial professional, contact us in writing at [ ].

Key Questions to Ask. *Ask our financial professionals these key questions about our investment services and accounts.*

1. Given my financial situation, why should I choose an advisory account?
2. Do the math for me. How much would I pay per year for an advisory account? What would make those fees more or less? What services will I receive for those fees?

- SAMPLE FIRM, an investment adviser registered with the Securities and Exchange Commission, April 1, 2018 -

3. What additional costs should I expect in connection with my account?
4. Tell me how you and your firm make money in connection with my account. Do you or your firm receive any payments from anyone besides me in connection with my investments?
5. What are the most common conflicts of interest in your advisory accounts? Explain how you will address those conflicts when providing services to my account.
6. How will you choose investments to recommend for my account?
7. How often will you monitor my account's performance and offer investment advice?
8. Do you or your firm have a disciplinary history? For what type of conduct?
9. What is your relevant experience, including your licenses, education, and other qualifications? Please explain what the abbreviations in your licenses are and what they mean.
10. Who is the primary contact person for my account? What can you tell me about his or her legal obligations to me? If I have concerns about how this person is treating me, who can I talk to?

- SAMPLE FIRM, an investment adviser registered with the Securities and Exchange Commission, April 1, 2018 -

Your Relationship with Your Financial Professional: Feedback on the Relationship Summary

We would like to know what you think about a proposed Relationship Summary that describes your relationship with your investment adviser or your broker-dealer (your firm) and your financial professionals. This document summarizes:

- the services the firm offers and the types of fees and costs associated with those services;
- the firm's obligations to you;
- certain conflicts of interest;
- how to find additional information about the firm and its financial professionals and research disciplinary history for the firm or its financial professionals;
- how to report a problem with your investments, investment account or a financial professional; and
- some questions to ask your financial professional to get more information.

It is important to us at the SEC to understand what you, the investor, think so that we can make it easier for you to choose the type of investment services relationship that is right for you. We prepared sample Relationship Summaries to illustrate what they may look like.

➢ Sample Relationship Summary for a broker-dealer

➢ Sample Relationship Summary for an investment adviser

➢ Sample Relationship Summary for firms that are both an investment adviser and broker-dealer

Please take a few minutes to review one or more of the samples and answer any or all of these questions. Please provide your comments by August 7, 2018 – and thank you for your feedback!

If you are interested in background information on the proposed Relationship Summary, or want to provide feedback on additional questions, click here (*https://www.sec.gov/rules/proposed/2018/34-83063.pdf*).

Questions

1. Overall, do you find the Relationship Summary useful? If not, how would you change it?
2. How useful is each section of the Relationship Summary? Please consider explaining your responses in the comments.

	Very Useful	Useful	Not Useful	Unsure	Comments
a. Types of Relationships and Services	O	O	O	O	
b. Our Obligations to You	O	O	O	O	
c. Fees and Costs	O	O	O	O	
d. Comparisons to different account types[1]	O	O	O	O	
e. Conflicts of Interest	O	O	O	O	
f. Additional Information	O	O	O	O	
g. Key Questions to Ask	O	O	O	O	

3. Please answer the following questions. Please consider explaining your responses in the comments.

	Yes	No	Somewhat	Comments
a. Do you find the format of the Relationship Summary easy to follow?	O	O	O	
b. Is the information in the appropriate order?	O	O	O	
c. Is the Relationship Summary easy to read?	O	O	O	
d. Should the Relationship Summary include additional information about different account types?	O	O	O	
e. Would you seek out additional information about a firm's disciplinary history as suggested in the Relationship Summary?	O	O	O	

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4. Are there topics in the Relationship Summary that are too technical or that could be improved? If so, what topics and how can they be improved?
5. Is there additional information that we should require in the Relationship Summary, such as more specific information about the firm or additional information about fees? Is that because you do not receive the information now, or because you would also like to see it presented in this summary document, or both? Is there any information that should be made more prominent?
6. Is the Relationship Summary an appropriate length? If not, should it be longer or shorter?
7. Do you find the 'Key Questions to Ask' useful? Would the questions improve the quality of your discussion with your financial professional? If not, why not?
8. Do you have any additional suggestions to improve the Relationship Summary? Is there anything else you would like to tell us?

How to Provide Feedback

You can send us feedback in the following ways (include the file number S7-08-18 in your response):

Mail	Secretary, Securities and Exchange Commission 100 F Street, NE Washington, DC, 20549-1090
Email	rule-comments@sec.gov
SEC Website	https://www.sec.gov/rules/proposed.shtml

We will post your feedback on our website. Your submission will be posted without change; we do not redact or edit personal identifying information from submissions. You should only make submissions that you wish to make available publicly.

Thank you!

[FR Doc. 2018–08583 Filed 5–8–18; 8:45 am]

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[1] Not applicable for firms that are both an investment adviser and broker-dealer.

TAB 5

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240, 249, 275 and 279

[Release No. 34–83063; IA–4888; File No. S7–08–18]

RIN 3235–AL27

Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is proposing new and amended rules and forms under both the Investment Advisers Act of 1940 (''Advisers Act'') and the Securities Exchange Act of 1934 (''Exchange Act'') to require registered investment advisers and registered broker-dealers (together, ''firms'') to provide a brief relationship summary to retail investors to inform them about the relationships and services the firm offers, the standard of conduct and the fees and costs associated with those services, specified conflicts of interest, and whether the firm and its financial professionals currently have reportable legal or disciplinary events. Retail investors would receive a relationship summary at the beginning of a relationship with a firm, and would receive updated information following a material change. The relationship summary would be subject to Commission filing and recordkeeping requirements. The Commission also is proposing two rules to reduce investor confusion in the marketplace for firm services, a new rule under the Exchange Act that would restrict broker-dealers and associated natural persons of broker-dealers, when communicating with a retail investor, from using the term ''adviser'' or ''advisor'' in specified circumstances; and new rules under the Exchange Act and Advisers Act that would require broker-dealers and investment advisers, and their associated natural persons and supervised persons, respectively, to disclose, in retail investor communications, the firm's registration status with the Commission and an associated natural person's and/or supervised person's relationship with the firm.

DATES: Comments should be received on or before August 7, 2018.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an email to *rule-comments@sec.gov*. Please include File Number S7–08–18 on the subject line.

Paper Comments

- Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

All submissions should refer to File Number S7–08–18. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (*http://www.sec.gov/rules/proposed.shtml*). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. Investors seeking to comment on the relationship summary may want to submit our short-form tear sheet for providing feedback on the relationship summary, available at Appendix F.

Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Emily Rowland, Jennifer Songer, Gena Lai, Roberta Ufford, Jennifer Porter (Branch Chief), and Sara Cortes (Assistant Director), Investment Adviser Regulation Office at (202) 551–6787 or *IArules@sec.gov*, and Benjamin Kalish, Elizabeth Miller, Parisa Haghshenas (Branch Chief), and Holly Hunter-Ceci (Assistant Director), Chief Counsel's Office at (202) 551–6825 or *IMOCC@sec.gov*, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission is proposing new rule 204–5 under the Investment Advisers Act of 1940 [15 U.S.C. 80b],[1] and is proposing to amend Form ADV to add a new Part 3: Form CRS [17 CFR 279.1] under the Advisers Act. The Commission is also proposing to amend rules 203–1 [17 CFR 275.203–1], 204–1 [17 CFR 275.204–1], and 204–2 [17 CFR 275.204–2] under the Advisers Act. The Commission is proposing new rule 17a–14 under the Securities Exchange Act of 1934 [17 CFR 240.17a–14],[2] and new Form CRS [17 CFR 249.640] under the Exchange Act. The Commission is also proposing to amend rules 17a–3 [17 CFR 240.17a–3] and 17a–4 [17 CFR 240.17a–4] under the Exchange Act. The Commission is further proposing new rule 15l–2 under the Exchange Act [17 CFR 240.15l–2], new rule 15l–3 under the Exchange Act [17 CFR 240.15l–3], and new rule 211h–1 under the Advisers Act [17 CFR 275.211h–1].

[1] 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b, at which the Advisers Act is codified, and when we refer to rules under the Advisers Act, or any paragraph of these rules, we are referring to Title 17, Part 275 of the Code of Federal Regulations [17 CFR 275], in which these rules are published.

[2] 15 U.S.C. 78a. Unless otherwise noted, when we refer to the Exchange Act, or any paragraph of the Exchange Act, we are referring to 15 U.S.C. 78a, at which the Exchange Act is codified, and when we refer to rules under the Exchange Act, or any paragraph of these rules, we are referring to Title 17, Part 240 of the Code of Federal Regulations [17 CFR 240], in which these rules are published.

I. Background

Individual investors rely on the services of broker-dealers and investment advisers when making and implementing investment decisions. Such ''retail investors'' can receive investment advice from a broker-dealer, an investment adviser, or both, or decide to make their own investment decisions.[3] A number of firms are dually registered with the Commission as broker-dealers and investment advisers, and offer both types of services.[4] Broker-dealers, investment advisers and dually registered firms all provide important services for individuals who invest in the markets. Studies show that retail investors are confused about the differences among them.[5] These differences include the scope and nature of the services they provide, the fees and costs associated with those services, conflicts of interest, and the applicable legal standards and duties to investors.

We recognize the benefits of retail investors having access to diverse business models and of preserving investor choice among brokerage services, advisory services, or both. We also believe that retail investors need clear and sufficient information in order to understand the differences and key characteristics of each type of service. Providing this clarity is intended to assist investors in making an informed choice when choosing an investment firm and professional, and type of account to help to ensure they receive services that meet their needs and expectations.

The Commission, as the primary regulator of both broker-dealers and investment advisers, has considered ways to address this confusion and preserve investor choice for some time, including through the RAND study of investor perspectives commissioned in 2006, the 913 Study conducted in 2010–2011, and a solicitation of data and other relevant information in 2013.[6] A number of approaches with a range of formats have been considered to address this issue, such as a statement by broker-dealers that an account is a brokerage account and not an advisory

[3] *See* Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011), at 10–11, *available at www.sec.gov/news/studies/2011/913studyfinal.pdf* (''913 Study''). As discussed below, we have considered the findings, conclusions and recommendations of the 913 Study in developing this proposal.

Retail investors also can choose to receive advisory services from other sources, such as banks, that are not required to be registered with the Commission.

[4] Investment advisers also may be registered with one or more states if, among other things, they have less than a certain amount of assets under management. *See* section 203A of the Advisers Act. References in this release to investment advisers generally refer only to SEC-registered investment advisers.

[5] *See, e.g.,* 913 Study, *supra* note 3. *See also* Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, *et al.,* (Sept. 15, 2010) (''CFA Survey'') (submitting the results of a national opinion survey regarding U.S. investors and the fiduciary standard conducted by ORC/Infogroup for the Consumer Federation of America, AARP, the North American Securities Administrators Association, the Certified Financial Planner Board of Standards, Inc., the Investment Adviser Association, the Financial Planning Association and the National Association of Personal Financial Advisors); Siegel & Gale, LLC/Gelb Consulting Group, Inc., *Results of Investor Focus Group Interviews About Proposed Brokerage Account Disclosures* (Mar. 5, 2005), *available at http://www.sec.gov/rules/proposed/s72599/focusgrp031005.pdf* (''Siegel & Gale Study''); Angela A. Hung, *et al.,* RAND Institute for Civil Justice, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008), *available at https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf* (''RAND Study'').

[6] *See* RAND Study, *supra* note 5; 913 Study, *supra* note 3; Duties of Brokers, Dealers, and Investment Advisers, Exchange Act Release No. 69013 (Mar. 1, 2013) [78 FR 14848 (Mar. 7, 2013)] (''2013 Request for Data'').

account, and encouraging investors to ask questions.[7] Through these initiatives, we have heard and considered the views of a wide range of commenters—financial firms, investors, consumer advocates, academics, and others. Improving retail investors' understanding of their different options for investment-related services through better disclosure is one key area on which commenters have focused. Commenters have suggested a range of presentations. Some commenters recommended a short disclosure document that explains the firm's services, fees, certain conflicts of interest, and the scope and nature of its services to the retail investor.[8] Others recommended a longer, more comprehensive narrative document such as the Form ADV Part 2 brochure that investment advisers are required to deliver to their clients.[9]

Similarly, the staff in the 913 Study and the Commission's Investor Advisory Committee, as part of its recommendation that the Commission adopt a fiduciary duty for broker-dealers, recommended uniform, simple, and clear summary disclosures to retail customers about the terms of their relationships with broker-dealers and investment advisers, including any material conflicts of interests.[10]

Disclosure has also been a feature of other regulatory efforts that address investment advice, including those of the U.S. Department of Labor (''DOL'') applicable to services provided by broker-dealers and investment advisers,[11] and rules applicable to broker-dealers issued by the Financial Industry Regulatory Authority (''FINRA'').[12]

In 2017, Commission Chairman Clayton continued the discourse on these issues by outlining a series of questions and welcoming the public to submit their views on standards of conduct and related disclosures for investment advisers and broker-dealers. More than 250 commenters responded.[13] Many commenters recommended enhanced disclosures in addition to regulations that would raise the standard of conduct for broker-dealers providing advice.[14] Some recommended that both broker-dealers and investment advisers should provide a uniform disclosure document to retail investors,[15] while others suggested new disclosure requirements only for broker-dealers.[16] Commenters also noted that investor confusion based on financial professionals' titles persists, and made a range of suggestions.[17] Specifically, some commenters believed that particular titles cause investors to either form misimpressions about whether the services received are those of an investment adviser and subject to a fiduciary duty, or these investors are misled by financial professionals to form such beliefs.[18]

Many commenters recommended a short disclosure document addressing the nature and scope of services, fees and material conflicts of interest.[19] These suggestions are consistent with our staff's financial literacy study,[20]

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[7] *See, e.g.,* Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 51523 (Apr. 12, 2005) [70 FR 20424, 20435 (Apr. 19, 2005)], at n.124 and accompanying text (''2005 Broker Dealer Release'').

[8] *See, e.g.,* Comment letters of Sammons Retirement Solutions (Jun. 4, 2013) and Insured Retirement Institute (Jul. 3, 2013) (recommending a short summary disclosure document together with a longer disclosure document similar to Form ADV, to be offered by both broker-dealers and investment advisers); Comment letter of AARP (Jul. 25, 2013); Comment letter of American Council of Life Insurers (Jul. 5, 2013) (incorporating by reference its comment letter, dated Aug. 30, 2010); Comment letter of Financial Services Institute (Jul. 5, 2013).

[9] *See, e.g.,* Comment letter of Committee of Annuity Insurers (Jul. 5, 2013); Comment letter of Edward D. Jones and Co., L.P. (Jul. 12, 2013); Comment letter of North American Securities Administrators Association, Inc. (Jul. 5, 2013); Comment letter of PFS Investments, Inc. (Jul. 5, 2013).

[10] *See* 913 Study, *supra* note 3, at 114–117. The 913 Study contemplated that the general relationship guide would be akin to Part 2A of Form ADV, which is generally referred to as an investment adviser's ''brochure'' and is the form investment advisers use to register with the Commission and states, which is provided to advisory clients. The 913 Study identified a number of potential disclosures that the Commission should consider including in such relationship guide. *See also* Recommendation of the Investor Advisory Committee: Broker-Dealer Fiduciary Duty, *available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/fiduciary-duty-recommendation-2013.pdf* (''Broker-Dealer Fiduciary Duty Recommendations''). The recommendation of the Investor Advisory Committee suggested that the disclosure be provided at the start of the engagement and periodically thereafter, and that it cover basic information about the nature of the services offered, fees and compensation, conflicts of interest, and disciplinary record.

[11] For example, DOL regulations relating to ''reasonable plan service arrangements'' require firms providing advisory and other services to workplace retirement plans covered by the Employee Retirement Income Security Act of 1974 (''ERISA'') and the prohibited transaction provisions under section 4975 of the Internal Revenue Code (''Code'') to disclose in writing (among other things) a description of services and applicable fees. *See* 29 CFR 2550.408b-2. *See also* 29 CFR 2550.408g–1 (regulation requires fiduciary advisers to plans and individual retirement accounts (''IRAs'') seeking to rely on the statutory exemption for participant investment advice to provide certain disclosures, among other conditions). *See also infra* Section IV.A.1.c, which further describes disclosure obligations under DOL regulations and exemptions, including the DOL's ''Best Interest Contract Exemption'' (the ''BIC Exemption'').

[12] Disclosure of Services, Conflicts and Duties, FINRA Notice 10–54 (Oct. 2010), *available at http://www.finra.org/sites/default/files/NoticeDocument/p122361.pdf* (''FINRA Notice 10–54'').

[13] Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers, Chairman Jay Clayton (Jun. 1, 2017), *available at https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31* (''Chairman Clayton's Request for Comment'').

[14] *See, e.g.,* Comment letter of T. Rowe Price (Oct. 12, 2017) (''T. Rowe 2017 Letter''); Comment letter of Vanguard (Sept. 29, 2017) (''Vanguard 2017 Letter''); Comment letter of Teachers Insurance and Annuity Association of America (Sept. 26, 2017) (''TIAA 2017 Letter''); Comment letter of the Investment Adviser Association (Aug. 31, 2017) (''IAA 2017 Letter''); Comment letter of Stifel, Nicolaus & Co. (Jul. 25, 2017) (''Stifel 2017 Letter''); Comment letter of Bernardi Securities, Inc. (Sept. 11, 2017) (''Bernardi Securities 2017 Letter''); Comment letter of UBS Financial Services Inc. (Jul. 21, 2017) (''UBS 2017 Letter''); Comment letter of SIFMA (Jul 21, 2017) (''SIFMA 2017 Letter''); Comment letter of the Equity Dealers of America (Sept. 11, 2017) (''Equity Dealers of America 2017 Letter''); Comment letter of AARP (Sept. 6, 2017) (''AARP 2017 Letter''); Comment letter of Financial Services Institute (Oct. 30, 2017); Comment letter of Financial Services Roundtable (Oct. 17, 2017) (''FSR 2017 Letter''); Comment letter of Consumer Federation of America (Sept. 14, 2017) (''CFA 2017 Letter'').

[15] *See, e.g.,* Stifel 2017 Letter; Equity Dealers of America 2017 Letter; Comment letter of Michael Kiley (Jul. 6, 2017) (''Kiley 2017 Letter''); Comment letter of the American Council of Life Insurers (Oct. 3, 2017) (''ACLI 2017 Letter''); Comment letter of Allianz Life Insurance Company of North America (Oct. 13, 2017) (''Allianz 2017 Letter''); AARP 2017 Letter; Comment letter of Robert Shaw (Jun. 5, 2017) (''Shaw 2017 Letter''); Comment letter of Alan Syzdek (Jul. 2 2017); Comment letter of Americans for Financial Reform (Sept. 22, 2017) (''AFR 2017 Letter'').

[16] *See, e.g.,* SIFMA 2017 Letter; Comment letter of the Investment Company Institute (Feb. 5, 2018); IAA 2017 Letter; Comment letter of Fidelity Investments (Aug. 11, 2017) (''Fidelity 2017 Letter''); Vanguard 2017 Letter; T. Rowe 2017 Letter; FSR 2017 Letter; UBS 2017 Letter; TIAA 2017 Letter; Comment letter of Wells Fargo & Company (Sept. 20, 2017) (''Wells Fargo 2017 Letter''); Bernardi Securities 2017 Letter; Comment letter of State Farm Mutual Automobile Insurance Company (Aug. 21, 2017) (''State Farm 2017 Letter''); Comment letter of PFS Investments Inc. (Dec. 10, 2017); Comment letter of Davis & Harman LLP (Jan. 18, 2018); Comment letter of LPL Financial LLC (Feb. 22, 2018).

[17] *See, e.g.,* CFA 2017 Letter; Comment letter of the Public Investors Arbitration Bar Association (Aug. 11, 2017) (''PIABA 2017 Letter''); IAA 2017 Letter; Comment letter of Pefin (Sept. 13, 2017) (''Pefin 2017 Letter''); Comment letter of Jackson National Life Insurance Company (Nov. 1, 2017) (''Jackson 2017 Letter''); Comment letter of CFA Institute (Jan. 10, 2018); Comment letter of First Ascent Asset Management (Jan. 10, 2018) (''First Ascent 2018 Letter'').

[18] *See e.g.,* CFA 2017 Letter; IAA 2017 Letter; Comment letter of the National Employment Law Project (Oct. 20, 2017) (''National Employment Law Project 2017 Letter'').

[19] *See, e.g.,* SIFMA 2017 Letter; UBS 2017 Letter; Stifel 2017 Letter; AARP 2017 Letter; Bernardi Securities 2017 Letter; Fidelity 2017 Letter; Allianz 2017 Letter.

[20] *See, e.g.,* Staff of the Securities and Exchange Commission, *Study Regarding Financial Literacy Among Investors as required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Aug. 2012), at iv, v, xiv, 37, 73, 121–23 and 131–32, *available at https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf* (''917 Financial Literacy Study'').

which found that retail investors favor a summary document and find these categories of disclosures, plus a financial intermediary's disciplinary history, to be important in choosing financial intermediaries.[21] Regarding investor confusion based on titles, commenters also recommended, for example, prohibiting the use of certain terms in titles, and prohibiting a firm not registered as an investment adviser from holding itself out in a manner that implies it is an investment adviser.[22]

We agree that it is important to ensure that retail investors receive the information they need to understand the services, fees, conflicts, and disciplinary history of firms and financial professionals they are considering. Likewise, we believe that we should reduce the risk that retail investors could be confused or misled about the financial services they will receive as a result of the titles that firms and financial professionals use, and mitigate potential harm to investors as a result of that confusion. We also believe the information should be reasonably concise. Accordingly, we are proposing new rules to require broker-dealers and investment advisers to deliver to retail investors a customer or client relationship summary (''Form CRS'') that would explain general information about each of these topics.[23] Second, we are proposing rules that would (i) restrict the use of the terms ''adviser'' and ''advisor'' by broker-dealers and their associated financial professionals, and (ii) require broker-dealers and investment advisers to disclose in retail investor communications the firm's registration status while also requiring their associated financial professionals to disclose their association with such firm.

Together, these requirements would complement a separate release that the Commission is proposing concurrently to enhance existing broker-dealer conduct obligations (''Regulation Best Interest'').[24] Regulation Best Interest would establish a standard of conduct for broker-dealers and associated natural persons of broker-dealers to act in the best interest of a retail customer when making a recommendation of a securities transaction or investment strategy involving securities. While Regulation Best Interest would enhance the standard of conduct owed by broker-dealers to retail customers, it would not make that standard of conduct identical to that of investment advisers, given important differences between investment advisers and broker-dealers. The requirements we are proposing in this release would help an investor better understand these differences, and distinguish among different firms in the marketplace, which in turn should assist the investor in making an informed choice for the services that best suit her particular needs and circumstances.

II. Form CRS Relationship Summary

We are proposing to require registered investment advisers and registered broker-dealers to deliver a relationship summary to retail investors. In the case of an investment adviser, initial delivery would occur before or at the time the firm enters into an investment advisory agreement with the retail investor; in the case of a broker-dealer, initial delivery would occur before or at the time the retail investor first engages the firm's services. Dual registrants would deliver the relationship summary at the earlier of entering into an investment advisory agreement with the retail investor or the retail investor engaging the firm's services.[25]

The relationship summary would be as short as practicable (limited to four pages or equivalent limit if in electronic format), with a mix of tabular and narrative information, and contain sections covering: (i) Introduction; (ii) the relationships and services the firm offers to retail investors; (iii) the standard of conduct applicable to those services; (iv) the fees and costs that retail investors will pay; (v) comparisons of brokerage and investment advisory services (for standalone broker-dealers and investment advisers); (vi) conflicts of interest; (vii) where to find additional information, including whether the firm and its financial professionals currently have reportable legal or disciplinary events and who to contact about complaints; and (viii) key questions for retail investors to ask the firm's financial professional. Form CRS would be required by Form ADV Part 3 and rule 204–5 of the Advisers Act for investment advisers, and by Form CRS and rule 17a–14 of the Exchange Act for broker-dealers.[26]

We are proposing to define ''relationship summary'' as a written disclosure statement that firms must provide to retail investors.[27] A ''retail investor'' would be defined as a prospective or existing client or customer who is a natural person (an individual).[28] All natural persons would be included in the definition, regardless of the individual's net worth (thus including, *e.g.,* accredited investors, qualified clients or qualified purchasers).[29] The definition would

[21] *See, e.g.,* 917 Financial Literacy Study, *supra* note 20, at iv, x–xiii, xxi, 37, 66–67, 73, 119.

[22] *See, e.g.* Comment letter of Mark D. Moss (Jun. 2, 2017); Comment letter of Gimme Credit (Aug. 8, 2017); PIABA 2017 Letter; AFL–CIO 2017 Letter; IAA 2017 Letter; Pefin 2017 Letter; Jackson 2017 Letter; AFR 2017 Letter; National Employment Law Project 2017 Letter; First Ascent 2018 Letter.

[23] For investment advisers, Form CRS would be required by Form ADV Part 3. For broker-dealers, Form CRS would be required by proposed new rule 17a–14 under the Exchange Act. When we refer to Form CRS in this release, we are referring to Form CRS for both broker-dealers and investment advisers.

[24] Regulation Best Interest, Exchange Act Release No. 34–83062 (Apr. 18, 2018) (''Regulation Best Interest Proposal'').

[25] For purposes of the relationship summary, we propose to define dual registrant as a firm that is dually registered as a broker-dealer and an investment adviser and offers services to retail investors as both a broker-dealer and investment adviser. Proposed General Instruction 9.(b) to Form CRS. Accordingly, a firm that is registered with the Commission as a broker-dealer and with one or more states as an investment adviser would be a dual registrant.

[26] We propose to amend Form ADV, which investment advisers must file to register with the Commission and with state securities regulators, to include a new Part 3: Form CRS that describes the requirements for the relationship summary, and we propose conforming technical amendments to the General Instructions of Form ADV. *See* proposed amendments to Advisers Act rule 203–1; proposed amendments to General Instructions to Form ADV. We also propose a rule 17a–14 to require a Form CRS for broker-dealers registered with the Commission. *See* Exchange Act proposed rule 17a–14. Advisers use Form ADV to apply for registration with us (Part 1A) or with state securities authorities (Part 1B), and must keep it current by filing periodic amendments as long as they are registered. *See* Advisers Act rules 203–1 and 204–1. Form ADV has two parts. Part 1(A and B) of Form ADV provides regulators with information to process registrations and to manage their regulatory and examination programs. Part 2 is a uniform form used by investment advisers registered with both the Commission and the state securities authorities. *See* Instruction 2 of General Instructions to Form ADV. This release discusses the Commission's proposal of Form ADV Part 3: Form CRS and related rules applicable to advisers registered with the Commission. To the extent that state securities authorities could consider making similar changes that affect advisers registered with the states, we can forward comments to the North American Securities Administrators Association (''NASAA'') for consideration by the state securities authorities.

[27] Proposed General Instruction 9.(d) to Form CRS.

[28] Proposed General Instruction 9.(e) to Form CRS.

[29] Advisers Act proposed rule 204–5(d)(2) and Exchange Act proposed rule 17a–14(e)(2); proposed General Instruction 9.(e) to Form CRS. We recognize that the definition of ''retail investor'' would differ from that of ''retail customer,'' as used in Regulation Best Interest. ''Retail customer'' for broker-dealers under Regulation Best Interest would be defined as ''a person, or the legal representative of such person, who: (1) 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 (2) uses the recommendation primarily for personal, family, or household purposes.'' Regulation Best Interest Proposal, *supra* note 24, section II.C.4. We believe it is beneficial to require firms to provide a relationship summary to all natural persons to

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include a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust.[30] We believe that this definition is appropriate because section 913 of the Dodd-Frank Act defines ''retail customer'' to include natural persons and legal representatives of natural persons without distinction based on net worth, and because financial literacy studies report deficiencies in financial literacy among the general population.[31] While studies also report variability in financial literacy among certain sub-sections of the general population,[32] we believe that all individual investors would benefit from clear and succinct disclosure regarding key aspects of their advisory and brokerage relationships.

As discussed further below, the relationship summary would be in addition to, and not in lieu of, current disclosure and reporting requirements for broker-dealers and investment advisers.[33] The relationship summary would alert retail investors to important information for them to consider when choosing a firm and a financial professional, and would prompt retail investors to ask informed questions. In addition, the content of the relationship summary would facilitate comparisons across firms that offer the same or substantially similar services. We are promoting these goals through specifying much of the content and presentation of Form CRS in the form's instructions (''Instructions''); while firms will be required to include firm-specific information in Form CRS, they will have limited discretion in the scope and presentation of that information. We are proposing that firms electronically file the relationship summary and any updates with the Commission, and therefore such filings would be subject to section 207 of the Advisers Act[34] and section 18 of the Exchange Act.[35] Investment advisers would file on the Investment Adviser Registration Depository (''IARD''), broker-dealers would file on the Commission's Electronic Data Gathering, Analysis and Retrieval System (''EDGAR''), and dual registrants would file on both IARD and EDGAR.

To aid firms in understanding the type of disclosures we propose to require, we have created mock-ups of a relationship summary for an investment advisory firm, a brokerage firm, and a dual registrant, and have included them as Appendices C–E to this release. The mock relationship summaries are for illustrative purposes only, reflect the business models of hypothetical firms, and are not intended to imply that they reflect a ''typical'' firm. They do not provide a safe harbor and, depending on the circumstances of a particular firm, a relationship summary that merely copies the mock-ups may not provide sufficient or accurate information about the firm, including for purposes of meeting the firm's obligations under the antifraud provisions of the federal securities laws. Investors seeking to comment on the relationship summary may want to submit our short-form tear sheet for providing feedback on the relationship summary, available at Appendix F. Below we request comments on all requirements of the relationship summary, including format, content, method of filing, method of delivery, updating, and other aspects as discussed below.

We preliminarily believe that providing this information before or at the time a retail investor enters into an investment advisory agreement or first engages a brokerage firm's services, as well as at certain points during the relationship (*e.g.,* switching or adding account types), as further discussed below, is appropriate and in the public interest and will improve investor protection, and will deter potentially misleading sales practices by helping retail investors to make a more informed choice among the types of firms and services available to them.[36]

A. Presentation and Format

We are proposing requirements designed to make the relationship summary short and easy to read. We believe that the required disclosure provides an overview of information that would help retail investors when choosing a firm, financial professional, and account type. The proposed formatting requirements would help retail investors, many of whom may not be sophisticated in legal or financial matters, to understand the information in the relationship summary and be in a better position to ask informed questions. The proposal is also informed by our experience with the mutual fund summary prospectus, which has illustrated the benefits of highlighting certain information in summary form, coupled with layered disclosure and disclosure designed to facilitate comparisons across investments.[37] We encourage firms to use innovative technology to create a relationship summary that is user-friendly, concise, easy-to-read, and more interactive than paper, and request comment below on ways to do so. The relationship summary would be provided to retail investors in addition to, and not in lieu of, any other required disclosures.[38]

As noted in the General Instructions, the requirements of the relationship summary are designed to promote effective communication between the firm and its retail investors.[39] First, as several commenters have recommended, we propose requiring that firms use ''plain language'' principles for the organization, wording, and design of the entire relationship summary, taking into consideration retail investors' level of financial sophistication.[40] Specifically,

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facilitate their understanding of account choices, regardless of whether they will receive investment advice primarily for personal, family, or household purposes. The relationship summary is intended for an earlier stage in the relationship between an investor and a financial professional, potentially before discussing the investment purposes of the investor. In contrast, Regulation Best Interest focuses on recommendations to ''retail customers'' who have chosen to engage the services of a broker-dealer after receiving the relationship summary.

[30] Advisers Act proposed rule 204–5(d)(2) and Exchange Act proposed rule 17a–14(e)(2); proposed General Instruction 9.(e) to Form CRS.

[31] *See* Federal Research Division, Library of Congress, *Financial Literacy Among Retail Investors in the United States* (Dec. 30, 2011), *available at https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part2.pdf* (''Library of Congress Report''). The Library of Congress Report is incorporated by reference into the 917 Financial Literacy Study, *supra* note 20, at Appendix 1.

[32] *See, e.g.,* 917 Financial Literacy Study, *supra* note 20, at viii (''In addition, surveys demonstrate that certain subgroups, including women, African-Americans, Hispanics, the oldest segment of the elderly population, and those who are poorly educated, have an even greater lack of investment knowledge than the average general population.''); Library of Congress Report, *supra* note 31, at 1.

[33] *See infra* Section II.C.

[34] 15 U.S.C. 80b–7.

[35] 15 U.S.C. 78r.

[36] *See* Exchange Act section 15(l)(2) and Advisers Act section 211(h)(2) (providing that the Commission shall examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, among other things, for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors).

[37] In a previous study, Commission staff found that most of the retail investors agreed that it was important to read a summary prospectus prior to investing in a mutual fund, and a majority of the retail investors surveyed on the mutual fund summary prospectus panel agreed that the actual summary prospectus they reviewed highlighted important information, was well-organized, written using words that they understood, clear and concise, and user friendly, and agreed that summary prospectuses contain the 'right amount' of information. 917 Financial Literacy Study, *supra* note 20, at xvii and xix.

[38] *See* Proposed General Instruction 3 to Form CRS. Broker-dealers and investment advisers have disclosure and reporting obligations under state and federal law, and broker-dealers are also subject to disclosure obligations under the rules of self-regulatory organizations. Delivery of the relationship summary would not necessarily satisfy a firm's other disclosure obligations.

[39] Proposed General Instruction 2 to Form CRS.

[40] Proposed General Instruction 2 to Form CRS. *See, e.g.,* PIABA 2017 Letter; State Farm 2017 Letter; Fidelity 2017 Letter; Comment letter of BlackRock (Aug. 7, 2017); Comment letter of the

firms would be required to be concise and direct and to use short sentences, active voice, and definite, concrete, everyday words.[41] Firms would not be permitted to use legal jargon, highly technical business terms or multiple negatives.[42] Firms should write the relationship summary as if addressing the retail investor, using ''you,'' ''us,'' or ''our firm.'' [43]

Second, we are proposing to require that, whether in electronic or paper format, the relationship summary should be no more than four 8½ x 11 inch pages if converted to Portable Document Format (''PDF''), using at least an 11 point font size, and margins of at least 0.75 inches on all sides.[44] For example, if delivered directly in the text of an email or in a mobile viewing format on the firm's website, the content of the relationship summary should not exceed this four-page PDF-equivalent length. This approach is consistent with our experience and commenters' suggestion that brief disclosure is more effective than a long-form narrative to focus retail investors on relevant information, and with suggestions from commenters who advocated for a clear, concise disclosure.[45] If delivered in paper, the paper size, font, and margin requirements would also encourage a clear presentation for retail investors, for example, by presenting important disclosures in a readable font-size and eliminating fine print.[46] Recognizing, however, that many firms deliver disclosures in electronic format and employ a variety of technologies to interact with prospective and existing retail investors, the Commission is requesting comment on formatting and other features of the relationship summary in electronic form.

In the past, the Commission has declined to impose page limits on disclosures required by the Investment Company Act of 1940 (''Investment Company Act''), including the summary prospectus, expressing concern that page limits could constrain appropriate disclosure and lead funds to omit material information about fund offerings.[47] The proposed relationship summary is intended to serve different purposes than the summary prospectus, including to provide a general overview of firms that could prompt a more detailed, individualized, and open conversation between the retail investor and his or her financial professional. The Commission preliminarily believes that the utility and effectiveness of the relationship summary lie in its brevity and conciseness; accordingly, we believe a page limit (or equivalent limit if in electronic format) is appropriate.

Brief disclosure would also facilitate a layered approach to disclosure in which firms would include certain information in the relationship summary, along with references and links to other disclosure where interested investors can find additional information.[48] The proposed relationship summary also would encourage retail investors to seek additional information in other ways, including through suggested questions for retail investors to ask their financial professional, as discussed further below.[49] These requirements are intended to create a concise summary that points out relevant areas for retail investors to focus on as they consider financial services, and the cross references and suggested questions facilitate investors' ability to choose to seek additional information. In addition, providing retail investors with a relationship summary containing specified information about the firm in a standardized format should aid retail investors' ability to compare firms at a higher level. The suggested questions and cross references to more information would enable them to more easily find and compare these details about the firms.

We considered requiring more detailed disclosure for broker-dealers similar to many items in the Form ADV brochure that advisers currently must deliver to clients. This longer disclosure would provide, for example, more information about fee amounts for specific accounts and products and more detailed descriptions of a wider range of conflicts of interest. We believe, however, that brief disclosure that focuses on the proposed topics would be more effective in capturing the attention of retail investors, encouraging them to explore certain key areas further, including by asking questions, and allowing them to make a quick comparison among a number of options.[50] We also encourage the use of methods, such as embedded hyperlinks, to direct retail investors to additional disclosures.

Alternatively, we considered shorter disclosure, such as a one-page document (or equivalent length if in electronic format) that would provide either a much abbreviated general description of a firm's services, fees, and conflicts, or a list of suggested questions for retail investors to discuss with their financial professional. We are concerned, however, that these approaches might not provide retail investors with enough information to compare firms and types of accounts. In addition, we are concerned that providing only a list of questions, without sufficient background information for investors to know why the question is important to ask, could make it less likely that investors would ask the questions or have an informed conversation. Only providing questions also would not ensure a standardized minimum of information that retail investors would receive across firms and therefore would not facilitate comparing firms or account types.

The relationship summary would require eight separate items covering: (i) Introduction; (ii) relationships and services the firm provides to retail investors; (iii) standard of conduct applicable to those services; (iv) the fees and costs that retail investors will pay; (v) comparisons of brokerage and investment advisory services (for standalone broker-dealers and investment advisers); [51] (vi) conflicts of

Investor Advisory Committee (Aug. 24, 2017); CFA 2017 Letter; AFR 2017 Letter; ACLI 2017 Letter; FSR 2017 Letter.

[41] Proposed General Instruction 2 to Form CRS.

[42] Proposed General Instruction 2 to Form CRS.

[43] Proposed General Instruction 2 to Form CRS.

[44] Proposed General Instruction 1.(c) to Form CRS.

[45] *See, e.g.,* Shaw 2017 Letter; SIFMA 2017 Letter; AFL–CIO 2017 Letter; AARP 2017 Letter; CFA 2017 Letter; AFR 2017 Letter; TIAA 2017 Letter; Vanguard 2017 Letter; ACLI 2017 Letter; FSR 2017 Letter; Allianz 2017 Letter.

[46] *See, e.g.,* 917 Financial Literacy Study, *supra* note 20, at xiii and 32.

[47] *See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) [74 FR 4546 (Jan. 26, 2009)], at 24 (''Enhanced Mutual Fund Disclosure Adopting Release'').

[48] Firms would be required to include cross-references to where investors could find additional information, such as in the Form ADV Part 2 brochure and brochure supplement for investment advisers or on the firm's website or in the account opening agreement for broker-dealers. For electronic versions of the relationship summary, we would require firms to use hyperlinks to the cross-referenced document if it is available online. *See* proposed Items 7.E.1. and 7.E.2. of Form CRS; proposed General Instruction 1.(g) to Form CRS.

[49] *See* proposed Item 8 of Form CRS.

[50] *See, e.g.,* 917 Financial Literacy Study, *supra* note 20, at 23–24 (citing CFA 2012 Letter, at 4–5).

[51] For purposes of the relationship summary, we propose to define a standalone investment adviser as a registered investment adviser that offers services to retail investors and (i) is not dually registered as a broker-dealer or (ii) is dually registered as a broker-dealer but does not offer services to retail investors as a broker-dealer. We propose to define a standalone broker-dealer as a registered broker-dealer that offers services to retail investors and (i) is not dually registered as an investment adviser or (ii) is dually registered as an investment adviser but does not offer services to retail investors as an investment adviser. Proposed General Instruction 9.(f) to Form CRS. We are including certain dual registrants in these proposed definitions because we understand that dual

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interest; (vii) where to find additional information, including whether the firm and its financial professionals currently have reportable legal or disciplinary events and who to contact about complaints; and (viii) key questions for retail investors to ask the firm's financial professional.[52] In order to promote comparison across firms, we would require firms to present this information under prescribed headings in the same order.[53] Firms also would be prohibited from including any information other than what the Instructions and the applicable item require or permit.[54] We believe that allowing only the required and specified permitted information would promote consistency of information presented to investors, allow retail investors to focus on information that we believe would be particularly helpful in deciding among firms, and help retail investors to decide what further information is needed. It would also encourage impartial information by preventing firms from adding information commonly used in marketing materials, such as performance.[55]

For certain items, firms will have some flexibility in how they include the required information.[56] For others, we are requiring firms to use prescribed wording, as discussed in the following sections. Firms may not include disclosure in the relationship summary other than disclosure that is required or permitted by the Instructions. We believe that this approach balances the need to provide firms flexibility in making the presentation of information consistent with their particular business model while ensuring that all investors receive certain information regardless of the firm. The information in the relationship summary must accurately reflect the characteristics of the particular firm and the services that it offers. Accordingly, all information in the relationship summary must be true and may not omit any material facts necessary to make the required disclosures not misleading.[57] If a statement is inapplicable to a firm's business or would be misleading to a reasonable retail investor, the firm may omit or modify that statement.[58]

Based on studies that indicate the effectiveness of graphical presentation for retail investors,[59] we are prescribing the use of graphical formats in specified circumstances. For example, dual registrants would be required to present all of the information required by Items 2 through 4 and Item 6 in a tabular format,[60] comparing advisory services and brokerage services side-by-side, with prescribed headings.[61] Similarly, standalone broker-dealers and investment advisers would be required to provide general information about fee types in tabular format, in a separate comparison section.[62] All firms would be permitted to use charts, graphs, tables, and other graphics or text features to explain the information, so long as the information is responsive to and meets the requirements in the Instructions (including the space limitations).[63] The use of a graphical presentation would be prohibited if it is inaccurate or misleading or, because of its nature, quantity, or manner of presentation, obscures or impedes understanding of the information that is required to be included. Firms that choose to use interactive graphics or tools may include Instructions on their use and interpretation.[64] We believe that standardizing the relationship summaries among firms by specifying the headings, sequence, and content of the topics; prescribing language for firms to use as applicable; and limiting the length of the relationship summary will provide comparative information in a user-friendly manner that helps retail investors with informed decision-making.[65]

We request comment on the following for the relationship summary.

- Should firms only be required to deliver the relationship summary to retail investors? Or should they be required to deliver one to other types of investors, too, such as individuals representing sole proprietorships or other small businesses, or institutional investors that are not natural persons, including workplace retirement plans and funds? Would such investors have the need for the information in the relationship summary to facilitate a choice among different firms, financial professionals, and account types? Or would these investors rely directly on the more detailed disclosures in the Form ADV Part 2 brochure or pursuant to Regulation Best Interest?
- Should retail investors be defined for purposes of Form CRS to include all natural persons, as proposed? Should we instead exclude certain categories of natural persons based on their net worth or income level, such as accredited investors,[66] qualified clients,[67] or

registrants do not always offer both brokerage and advisory accounts to retail investors. For example, some dual registrants offer advisory accounts to retail investors, but offer brokerage broker-dealer services only to institutions (*e.g.,* for their underwriting services).

[52] *See* proposed Items 1–8 of Form CRS.

[53] Proposed General Instruction 1.(b) and (e) to Form CRS. *See also e.g.,* proposed Items 2.A., 3.A., 4.A., 5.A. and 5.B., 6.A., 7.A., and 8 of Form CRS.

[54] Proposed General Instruction 1.(d) to Form CRS.

[55] Although performance disclosure is a subject on which the Commission focuses, including to promote accuracy, consistency, and comparability, such disclosure is not the subject of this initiative.

[56] *See, e.g.,* proposed General Instruction 1.(f) to Form CRS (''You may use charts, graphs, tables, and other graphics or text features to explain the required information, so long as the information (i) is responsive to and meets the requirements in these instructions (including space limitations); (ii) is not inaccurate or misleading; and (iii) does not, because of the nature, quantity, or manner of presentation, obscure or impede understanding of the information that must be included. When using interactive graphics or tools, you may include instructions on their use and interpretation.''); proposed Items 2.B., 2.C., and 6.B. of Form CRS.

[57] Firms should keep in mind the applicability of the antifraud provisions of the federal securities laws, including section 206 of the Advisers Act, section 17(a) of the Securities Act, and section 10(b) of the Exchange Act and rule 10b–5 thereunder, in preparing the relationship summary.

[58] *See* proposed General Instruction 3 to Form CRS. Firms may omit or modify prescribed wording or other statements required to be part of the relationship summary if such statements are inapplicable to a firm's business or would be misleading to a reasonable retail investor.

[59] *See* 917 Financial Literacy Study, *supra* note 20, at iv, xx, 21–22; *see also* Benbasat & Dexter, *infra* note 592.

[60] Empirical evidence suggests that visualization improves individual perception of information (*see* Hattie, *infra* note 591) and that tabular reports may lead to better decision making (*see* Benbasat & Dexter, *infra* note 592).

[61] Dual registrants must present the information in Items 2 through 4 and Item 6 in a tabular format, comparing advisory services and brokerage services side-by-side. In the column discussing brokerage services, firms must include the heading ''Broker-Dealer Services'' and the sub-heading ''Brokerage Accounts.'' In the column discussing investment advisory services, firms must include the heading ''Investment Adviser Services'' and the sub-heading ''Advisory Accounts.'' *See* proposed General Instruction 1.(e) to Form CRS.

[62] Standalone broker-dealers and investment advisers would be required to include the sub-heading ''You can receive advice in either type of account, but you may prefer paying:'' and present prescribed information comparing a transaction-based fee and an asset-based fee in side-by-side columns, in a tabular format. *See* proposed Items 5.A.4. and 5.B.6. of Form CRS.

[63] Proposed General Instruction 1.(f) to Form CRS.

[64] *Id.*

[65] Empirical evidence suggests that users are better able to make coherent, rational decisions when they have comparative, standardized disclosure that allows them to assess relevant trade-offs. *See infra* note 593 and accompanying text.

[66] Accredited investors include natural persons who (i) have a net worth over $1 million, either individually or together with a spouse (excluding the value of the primary residence); (ii) had an individual income greater than $200,000 (or $300,000 together with a spouse) in each of the two most recent years, and has a reasonable expectation of reaching the same income level in the current year; or (iii) for purposes of a securities offering of a particular issuer, are directors, executive officers, or general partners of that issuer. Accredited investors also include non-natural persons, such as, banks, broker-dealers, insurance companies, investment companies registered under the Investment Company Act of 1940, and certain partnerships, corporations, nonprofit entities, retirement plans, and trusts. 17 CFR 230.501.

[67] A qualified client is a client that meets one or more of the following criteria: (i) Is a natural person

qualified purchasers? [68] If we did exclude certain categories of natural persons based on their net worth, what threshold should we use for measuring net worth? Should we exclude certain categories of natural persons for other reasons?

• Should we conform the definition of retail investor to the definition of retail customer as proposed in Regulation Best Interest, which would include non-natural persons who use the recommendation primarily for personal, family, or household purposes? Should the definition of retail investor include trusts or similar entities that represent natural persons, as proposed? Are there other persons or entities that should be covered? Should we expand the definition to cover plan participants in workplace retirement plans who receive services from a broker-dealer or investment adviser for their individual accounts within a plan?

• Should we include any additional definitions of terms or phrases in the relationship summary? Should we omit any definitions we have proposed for the relationship summary? Should any of the proposed definitions be changed? If so, why?

• Will the length and presentation proposed for the relationship summary be effective for retail investors? Are there other approaches we should consider? What are the benefits and drawbacks of shorter or longer disclosure for retail investors relative to the proposed approach?

• We are proposing that the relationship summary discuss all of the firm's advisory and brokerage services in one relationship summary. Should we instead permit firms to prepare a separate relationship summary for different business lines or different programs or types of accounts and/or services that a broker-dealer or investment adviser offers? If we adopt such an approach, how could we modify the requirements to allow for comparison among account options within and across firms? For example, should we require that each such separate summary refer to the other summaries and include hyperlinks or other electronic features if presented on a firm's website? Should we require the use of hyperlinks that direct the investor directly to specific disclosure (*i.e.,* a ''deep link'') or a more general landing page? How would delivery obligations be formulated to ensure that retail investors receive sufficient but still user-friendly information?

• In the alternative, should we permit or require firms to prepare one relationship summary for the entire affiliated group or firm complex, *i.e.,* to summarize the services offered to retail investors of all affiliated companies together in a single relationship summary? What factors should dictate whether affiliates should be permitted or required to prepare a single relationship summary? For example, should we base any permissive instruction or requirement on whether the affiliates typically market services of multiple investment advisers and broker-dealer entities together? What about investment advisers and broker-dealers that are not affiliates but have partnership agreements, are part of one wrap fee program,[69] or other arrangements? Should they be required or permitted to cross-reference to other firms?

• Should we permit the relationship summary, or any part of it, to substitute for other disclosure obligations that broker-dealers or investment advisers have, if the disclosure obligations overlap? If so, for what disclosures could the relationship summary substitute? If not, why not?

• Does the proposal sufficiently encourage electronic design and delivery? Are there other ways we can modify the requirements to make clear that paper-based delivery is not the only permissible or desired delivery format?

• With respect to firms that use paper delivery to meet investor preferences, are the proposed presentation and content requirements appropriate for a relationship summary provided in paper or in PDF (*e.g.,* 11 point font, and have margins of at least 0.75 inches on all sides)? Would they be helpful in encouraging relationship summaries that address retail investors' preferences for concise and user-friendly information? If not, what requirements would improve the document's utility and accessibility for retail investors? In particular, are there any areas where requiring the use of a specific check-the-box approach, bullet points, tables, charts, graphs or other graphics or text features would be helpful in presenting any of the information or making it more engaging to retail investors? Should we include different requirements for font size, margins and paper size? Should we restrict certain types or sizes of font, color choices or the use of footnotes?

• Are there special technical specifications we should consider for other forms of electronic or online delivery on phones, tablets and other devices, and for information conveyed via videos, interactive graphics, or tools and calculators? Are the Instructions to the relationship summary sufficiently flexible to permit delivery on phones, tablets and other devices and to accommodate information conveyed via videos, interactive graphics, or tools and calculators? Should we require that firms make the relationship summary available by specific forms of electronic delivery or certain electronic devices? How can the Commission encourage investment advisers and broker-dealers to make fuller use of innovative technology to enable more interactive, user-friendly relationship summary disclosure, while still creating a short, easy-to-read relationship summary that includes the proposed content? Are there potential tools that the Commission should encourage or require firms to use in order to make

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or company that has at least $1 million in assets under management with the adviser immediately after entering into an investment advisory contract with the adviser; (ii) the adviser reasonably believes the natural person has a net worth (together with assets held jointly with a spouse) of more than $2.1 million immediately prior to entering into an advisory contract (excluding the value of the primary residence); (iii) the adviser reasonably believes the natural person or company is a ''qualified purchaser'' as defined in section 2(a)(51)(A) of the Investment Company Act at the time an advisory contract is entered into; (iv) is an executive officer, director, trustee, general partner, or person serving in a similar capacity, of the adviser; or (v) is an employee of the adviser who participates in the investment activities of the adviser, and has performed investment activities for at least twelve months. The dollar thresholds under the definition of qualified client are subject to inflation adjustments every five years. 17 CFR 275.205–3(d)(1); Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205–3 under the Investment Advisers Act of 1940, Investment Advisers Act Release No. 4421 (Jun. 14, 2016) [81 FR 39985 (Jun. 20, 2016)].

[68] The term ''qualified purchaser'' has been defined for purposes of the Investment Company Act and for the Securities Act. Under the Investment Company Act, the term ''qualified purchaser'' includes any natural persons who or certain family-owned companies that own not less than $5 million in investments; certain trusts; and any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than $25 million in investments. 15 U.S.C. 80a–2(a)(51)(A).

For purposes of section 18(b)(3) of the Securities Act, the term ''qualified purchaser'' means any person to whom securities are offered or sold pursuant to a Tier 2 offering as defined in Regulation A. 17 CFR 230.256. Tier 2 offerings generally may be sold only to (i) accredited investors; (ii) natural persons for whom the aggregate purchase price to be paid by the purchaser for the securities is no more than 10% of the purchaser's annual income or net worth; or (iii) non-natural persons for which the aggregate purchase price to be paid by the purchaser for the securities is no more than 10% of its revenue or net assets for the most recently completed fiscal year. 17 CFR 230.251.

[69] A wrap fee program would be defined as an advisory program under which a specified fee or fees not based directly upon transactions in a retail investor's account is charged for investment advisory services and the execution of retail investor transactions. Proposed General Instruction 9.(g) to Form CRS. *See infra* note 173.

their disclosures more interactive and understandable? For instance, should we permit or require a firm to use pop-ups or hovers to provide retail investors with additional information required or permitted by the relationship summary, without retail investors having to scroll to find the information in another section of the relationship summary? Would this tool be useful for firms to use, for example, in the Introduction section of the relationship summary, so that a retail investor could access upfront additional information about the terms used (advisory and brokerage accounts) that is presented in other sections of the relationship summary? Instead of requiring and permitting hyperlinks in certain circumstances (*e.g.,* to link to an adviser's Form ADV or a fee schedule), are there other technological tools that would better help an investor find information that is cross-referenced in the relationship summary? Should we permit or require other technologies (such as QR codes [70]) in addition to or in lieu of hyperlinks to connect to such information?

- Would retail investors be more likely to read a firm's relationship summary if we required or permitted firms to use certain design elements—such as larger font sizes or greater use of white space, colors, or visuals? Could this be accomplished while still providing retail investors with the information we are proposing to require in a short and easy-to-read relationship summary?
- We are proposing that the firm use plain language principles and the Instructions refer to the SEC's Plain English Handbook. Should we modify any of these principles? Should the Instructions refer to any other principles to promote understandable wording?
- Do firms commonly market to non-English speakers or provide information—including marketing materials—in languages other than English? To what extent would firms expect to deliver a relationship summary in a language other than English? Should we propose requirements to prepare relationship summaries in languages other than English? For example, should we require that firms prepare, file, and deliver a relationship summary in any language in which they disseminate marketing materials? Are there concerns with translating the relationship summary without also having to translate the firm's other disclosures? If so, what are those concerns?
- Should we limit the relationship summary to four pages (or equivalent limit if in electronic format), as proposed? Is this enough space for firms to provide meaningful information? Should we instead eliminate page limits (and their equivalent for electronic format) or increase the amount of permitted pages or their equivalent? Are there particular items that may require longer responses than others? If so, how should the Commission take these into account in considering page limits? For example, if commenters believe the use of graphics will be more effective to communicate fees, should we permit a greater number of pages to account for the use of graphics? Conversely, will retail investors read four pages? Should the page limit be shorter, such as one to three pages? If so, what information in the proposed requirements should we omit? Should we have different page limits for dual registrants than for firms that offer only brokerage or only advisory services? If we do require shorter disclosure, what information should firms be required to provide regardless of the length?
- Are there too few or too many items that would be required in the relationship summary? Are there other items that we should also require or proposed items that we should delete? Do commenters agree that we should only permit the items required by the relationship summary? Is there other information that we should permit, but not require, firms to include? If so, what items are those?
- Do commenters agree that all items should be presented in the same order under the same heading to promote comparability across firms? Why or why not? If the items are not listed in the same order, could retail investors still easily compare firm relationship summaries? Does the prescribed order work, or should we consider a different order? Is there information that we should always require to appear on the first page or at the beginning of an electronic relationship summary? Are there any specifications we should include to enhance comparability for electronic delivery of the relationship summary in various forms?
- Should we, as proposed, prescribe headings for each item or allow firms to choose their own headings? Should we require or permit a different style of headings, such as a question and answer format or other wording to encourage retail investors to continue reading?
- Should we permit firms to include additional disclosure with the relationship summary, such as a comprehensive fee table, or other disclosures? Would the inclusion of additional disclosures affect whether retail investors would view the relationship summary? What are the benefits and drawbacks of such an approach?
- Should we generally permit firms to use charts, graphs, tables, and/or other graphics or text features to explain the information required by the relationship summary (so long as any such feature meets requirements as specified in the Instructions), as proposed? Should we permit firms to choose the graphical presentation that they will use? Are there specific graphical presentations that we should require? Should we permit other mediums of presentation, such as the use of video presentations?
- Do any elements of the proposed presentation requirements impose unnecessary costs or compliance challenges? Please provide specific data. Are there any changes to the proposal that could lower those costs? Please provide examples.
- Are the mock relationship summaries useful and illustrative of the proposed form requirements? Do they appropriately show the level of detail that firms might provide?

With respect to each item for which we prescribe wording in the relationship summary, we request the following comment on each of those required disclosures:

- Does the narrative style work for the prescribed wording or are there other presentation formats that we should require? Should the Commission instead require more prescribed wording? Conversely, is there prescribed wording we have proposed that we should modify or replace with a more general instruction that allows firms to use their own description?

B. Items

1. Introduction

We are proposing that the beginning of the relationship summary contain a title highlighting the types of investment services and accounts the firm offers to retail investors, specifically ''Which Type of Account is Right for You—Brokerage, Investment Advisory or Both?'' for dual registrants and ''Is a[n] [Brokerage/Investment Advisory] Account Right for You?'' for standalone brokerage firms or investment advisory firms, respectively.[71] A firm also would be required to include its name, whether it is registered with the Commission as a broker-dealer, investment adviser, or

[70] A QR code is a two-dimensional barcode capable of encoding information such as a website address, text information, or contact information. These codes are becoming increasingly popular in print materials and can be read using the camera on a smartphone.

[71] Proposed Items 1.B., 1.C. and 1.D. of Form CRS.

both, and date of the relationship summary prominently on the first page or beginning of the electronic disclosure (this information could be included in the header or footer).[72]

An introductory paragraph would briefly explain the types of accounts (brokerage accounts and/or investment advisory accounts) and services the firm offers. Using prescribed wording, all firms would be required to state: ''There are different ways you can get help with your investments. You should carefully consider which types of accounts and services are right for you.'' In a new paragraph and using prescribed wording and bold font, a standalone broker-dealer would be required to state: ''We are a broker-dealer and provide brokerage accounts and services rather than advisory accounts and services.'' [73] Likewise, a standalone investment adviser would be required to state in bold font: ''We are an investment adviser and provide advisory accounts and services rather than brokerage accounts and services.'' [74] Dual registrants would include a similar statement in bold font that discusses both types of services, specifically: ''Depending on your needs and investment objectives, we can provide you with services in a brokerage account, investment advisory account, or both at the same time.'' [75] Finally, all firms would be required to include: ''This document gives you a summary of the types of services we provide and how you pay. Please ask us for more information. There are some suggested questions on page [ ].'' [76]

The proposed introductory paragraph sets up a key theme of the relationship summary—helping retail investors to understand and make choices among account types and services. For example, some retail investors want to receive periodic recommendations while others prefer ongoing advice and monitoring. Some retail investors wish to pursue their own investment ideas and direct their own transactions, while others seek to delegate investment discretion to the firm. Emphasizing that there are different types of accounts and services from which a retail investor may choose would help the retail investor make an informed choice about whether the firm provides services that are the right fit for his or her needs and help the retail investor to choose the right firm or account type. Although the disclosures are intentionally simplified and generalized, we believe they would help retail investors to obtain more detailed information.

We request comment generally on the proposed requirement for firms to include specific information in the introduction.

• In addition to the title, firm name and SEC registration status, and date, is there other information that we should require at the beginning of the relationship summary? Should we instead require a cover page? Are the titles we proposed in the Instructions appropriate? What alternatives should we consider? Should we allow firms to select their own title for the relationship summary?

• Should we require firms to include the prescribed wording, as proposed, or should we allow more flexibility in the words they use? Should we modify the prescribed wording? Does the proposed wording capture the range of business models among investment advisers and broker-dealers? Would the prescribed wording require a firm to provide any inaccurate information given that firm's circumstances? Instead of the proposed prescriptive wording, should the Commission permit or require a more open-ended narrative?

• Is there additional information we should require in the introduction?

• Should we require that standalone brokerage and investment advisory firms include a statement that the retail investor may instead prefer investment advisory or brokerage services, respectively? Why or why not?

2. Relationships and Services

After the introduction, the proposed relationship summary would provide information about the relationships between the firm and retail investors and the investment advisory account services and/or brokerage account services the firm provides to retail investors.[77] The section would begin with the heading ''Relationships and Services'' for a standalone broker-dealer or investment adviser.[78] A dual registrant would use the heading ''Types of Relationships and Services,'' followed by this statement: ''Our accounts and services fall into two categories.'' [79] Each firm would discuss specific information about the nature, scope, and duration of its relationships and services, including the types of accounts and services the firm offers, how often it offers investment advice, and whether the firm monitors the account.

This item requires firms to provide specific information with a mix of prescribed wording and short narrative statements. As discussed above, if a prescribed statement is not applicable to the firm's business or would be misleading to a reasonable retail investor, the firm would be permitted to omit or modify that statement.[80] We have designed these requirements to provide retail investors with consistent, concise, and meaningful information about the services they would receive from a firm and help them to ask relevant questions, compare firms' services against each other, and make more informed choices about the services they choose.

We considered an approach whereby firms would be required to complete a prescribed checklist of common characteristics of brokerage and advisory accounts, indicating which characteristics applied to their accounts and services. This approach could improve comparability among firms. We are concerned, however, that this approach would not be sufficiently flexible to accommodate the variety of business models and services that broker-dealers and advisers provide, and that a mix of prescribed wording and narrative format would help investors better understand the firm's services. We believe that our proposed approach provides enough information to help retail investors understand and choose between investment advisory accounts and brokerage accounts without overwhelming them with too much information.

Brokerage Account Services. We propose requiring broker-dealers to summarize the principal brokerage services that they provide to retail investors.[81] First, broker-dealers would include the following wording to explain the transaction-based nature of their fees (emphasis required): ''If you open a brokerage account, you will pay us a *transaction-based fee,* generally referred to as a commission, every time you buy or sell an investment.'' [82] Even though a separate section of the relationship summary would discuss a firm's fees, we believe it is important for broker-dealers to explain transaction-based fees at the beginning of the

[72] Proposed Item 1.A. of Form CRS. The disclosure of Commission registration would make the relationship summary consistent with proposed rules 15l–3 of the Exchange Act and 211h–1 of the Advisers Act, which would require that a broker-dealer and a registered investment adviser prominently disclose that it is registered with the Commission as a broker-dealer or investment adviser, respectively, in print or electronic retail investor communications.

[73] Proposed Item 1.B. of Form CRS.

[74] Proposed Item 1.C. of Form CRS.

[75] Proposed Item 1.D. of Form CRS.

[76] Proposed Items 1.B.—1.D. of Form CRS.

[77] Proposed Item 2 of Form CRS.

[78] Proposed Item 2.A. of Form CRS.

[79] *Id.*

[80] *See supra* note 58 and accompanying text.

[81] Proposed Item 2.B. of Form CRS.

[82] Proposed Item 2.B.1. of Form CRS.

disclosure because these types of fees are typically a critical distinction between brokerage and investment advisory accounts.[83]

Next, broker-dealers that offer accounts in which they offer recommendations to retail investors would state that the retail investor may select investments or the broker-dealer may recommend investments for the retail investor's account, but that the retail investor will make the ultimate investment decision regarding the investment strategy and the purchase or sale of investments.[84] Broker-dealers that offer accounts in which they do not offer recommendations to retail investors (*e.g.,* execution-only brokerage services) would state that the retail investor will select the investments and make the ultimate investment decision regarding the investment strategy and the purchase or sale of investments.[85] Starting with a clear description of the services provided in a brokerage account by a broker-dealer—including the retail investor's choice of receiving recommendations or self-directing his or her investments, and the fact that the retail investor will make the ultimate investment decision—would help address confusion about the services that broker-dealers offer to retail investors.[86] This language also highlights differences from the services that investment advisers would describe, discussed below.

Next, we propose requiring broker-dealers to state if they offer additional services to retail investors, including, for example: (a) Assistance with developing or executing the retail investor's investment strategy (*e.g.,* the broker-dealer discusses the retail investor's investment goals or designs with the retail investor a strategy to achieve the retail investor's investment goals); or (b) monitoring the performance of the retail investor's account.[87] They would also state that a retail investor might pay more for these additional services, if applicable.[88] Broker-dealers that offer performance monitoring as part of the standard brokerage account services would indicate how frequently they monitor the performance.[89] While broker-dealers do not undertake to provide investment strategy and performance monitoring services when they give recommendations, we recognize that many broker-dealers offer these services to retail investors as part of their account agreement. We believe that retail investors would benefit from disclosure that such services exist, and that broker-dealers might charge higher fees for these services. Broker-dealers would also be required to briefly describe any regular communications they have with retail investors, such as providing account statements, giving an overview of transactions during a period, or evaluating the account's performance.[90] Firms would include the frequency (*e.g.,* at least quarterly) and the method (*e.g.,* by email, phone or in person) of the communications.[91]

Finally, broker-dealers would be required to include the following if they significantly limit the types of investments available to retail investors in any accounts: ''We offer a limited selection of investments. Other firms could offer a wider range of choices, some of which might have lower costs.'' [92] A broker-dealer would significantly limit the types of investments if, for example, the firm only offers one type of asset (*e.g.,* mutual funds, exchange-traded funds, or variable annuities), the firm only offers mutual funds or other investments sponsored or managed by the firm or its affiliate (*i.e.,* proprietary products), or the firm only offers a small choice of investments.[93] In addition, if the limitations only apply to some of the accounts the firm offers, such as, for example, limiting the types of investments for retail investors within different asset tiers, then the firm would have to identify those accounts.[94]

Limitations on investments offered could have a significant effect on investor choice and performance of the account over time. In particular, firms that offer proprietary products exclusively preclude investor access to competing products that could offer lower fees or result in better performance over time. As a result, retail investors should understand these limitations before they enter into a relationship with a firm.

Advisory Account Services. We propose requiring investment advisers that offer investment advisory accounts to retail investors to summarize the principal investment advisory services provided to retail investors.[95] First, investment advisers would be required to state the type(s) of fee they receive as compensation if a retail investor opens an investment advisory account.[96] For example, an investment adviser would state if it charges an on-going asset-based fee based on the value of the cash and investments in the advisory account, a fixed fee, or some other fee arrangement. A standalone adviser would also state how frequently it assesses the fee.[97] Similar to the requirement for broker-dealers,[98] we are proposing to require a statement about how investment advisers charge fees up-front because of the importance that investors understand how they will pay for services and to highlight this critical distinction between brokerage and advisory accounts. We are proposing to require that firms describe additional fees associated with these services in the discussion of fees and costs. Because the fees charged by each investment adviser may differ, we are not prescribing specific wording and instead are allowing firms flexibility in choosing the exact wording to use for this disclosure. Advisers would, however, emphasize the type of fee in bold and italicized font.[99]

Next, investment advisers would state that they offer advice on a regular basis, or, if they do not offer advice on a regular basis, they would state how frequently they offer advice.[100] They would also state the services they offer to retail investors including, for example, (a) assistance with developing the retail investor's investment strategy (*e.g.,* the investment adviser discusses the retail investor's investment goals or designs with the retail investor a strategy to achieve the retail investor's investment goals), or (b) how frequently

[83] *See infra* note 126 (discussing our use of the term ''transaction-based fees'' in the relationship summary).

[84] Proposed Item 2.B.2. of Form CRS.

[85] *Id.*

[86] We believe that retail investors have the ultimate investment decision for their investment strategy and the purchase or sale of investments, even if the broker-dealer has temporary or limited discretion over retail investors' accounts. *See* Regulation Best Interest Proposal, *supra* note 24, at section II.F.

[87] Proposed Item 2.B.3. of Form CRS.

[88] *Id.*

[89] *Id.* Broker-dealers that monitor the performance of the retail investor's account, as market and customer conditions demand (rather than on a specific time schedule), could state so.

[90] *Id.*

[91] *Id.* We are proposing the same requirement for investment advisers, described below. *See infra* note 102 and accompanying text.

[92] Proposed Item 2.B.4. of Form CRS.

[93] *Id.*

[94] *Id.*

[95] Proposed Item 2.C. of Form CRS.

[96] Proposed Item 2.C.1. of Form CRS. The relationship summary would refer to ''account advisory services'' and ''opening an account'' to simplify the explanations for retail investors. When an investment adviser provides investment advisory services, the client may have a custodial account with another firm, such as a broker-dealer or bank. A dual registrant may maintain custody for an advisory client's assets as broker-dealer. We are not proposing to require that firms include these nuances in the discussion of relationships and services.

[97] *Id.*

[98] *See supra* note 82 and accompanying text.

[99] Proposed Item 2.C.1 of Form CRS.

[100] Proposed Item 2.C.2. of Form CRS.

they monitor the retail investor's accounts.[101] Similar to broker-dealers, advisers would include the frequency (*e.g.,* at least quarterly) and the method (*e.g.,* by email, phone or in person) of the communications.[102] We believe that the regularity of advice and other services that investment advisers commonly provide, including, as applicable—discussions with the retail investor, designing a strategy to achieve investment goals, monitoring, and reporting on performance—are key aspects of services that advisers commonly provide.[103] As discussed above with respect to broker-dealers, these services can distinguish advisory accounts from brokerage accounts and therefore the disclosure will help retail investors determine which type of account best suits their needs.

Additionally, investment advisers would state if they offer advisory accounts for which they exercise investment discretion (*i.e.,* discretionary accounts), accounts for which they do not exercise investment discretion (*i.e.,* non-discretionary accounts), or both.[104] For purposes of this Item in the relationship summary, investment advisers generally should use the same definition of ''discretionary authority'' as in Form ADV, which is the authority to decide which securities to purchase and sell for the client, or the authority to decide which investment advisers to retain on behalf of the client.[105] If an investment adviser offers a discretionary account, the relationship summary would state that a discretionary advisory account allows the firm to buy and sell investments in the retail investor's account, without asking the retail investor in advance. For a non-discretionary advisory account, the relationship summary would state that the firm gives advice and the retail investor decides what investments to buy and sell.[106]

We believe it is important for retail investors considering an advisory account to understand the difference between discretionary services and non-discretionary services, as that distinction would affect the degree of control the retail investor would provide to the adviser. Discretionary advice is also a common feature of many investment advisory accounts,[107] so explaining discretion would benefit a retail investor in choosing between brokerage and investment advisory services, as well as between different types of advisory accounts.

Finally, as we are proposing for broker-dealers, investment advisers that significantly limit the types of investments available to retail investors in any accounts would include the same statement that broker-dealers would be required to include, and if such limits only apply to certain accounts, the investment adviser would identify those accounts, for the same reasons discussed above.[108]

Affiliate Services. We recognize that many investment advisers and broker-dealers that are not dual registrants nonetheless have affiliates that are broker-dealers or investment advisers, respectively. Often, these standalone firms offer their affiliates' services to retail investors. For example, an affiliated sub-adviser also may manage a portion of a retail investor's portfolio or an investment adviser may effect trades for client accounts through an affiliated broker-dealer. We would allow these firms to state that they offer retail investors their affiliates' brokerage or advisory services, as applicable.[109] We believe that the inclusion of this disclosure could make clear the choice investors have within affiliated firms and give financial professionals an opportunity to discuss these services.

We request comment generally on the proposed requirement for firms to include specific information about the relationships and services offered in their advisory and brokerage accounts.

- Would the proposed summary of relationships and services help retail investors to make informed choices about whether investment advisory or brokerage services better suit their needs? If not, how should we revise it?
- Would the proposed requirements result in disclosure that is clear, concise, and meaningful to retail investors? Would this information help retail investors to better understand the general differences in the services that investment advisers and broker-dealers provide? Are there other differences in the services provided by investment advisers and broker-dealers that we should require firms to discuss in this section? If so, should we permit or require information about those differences in the summary of services? Are there any common misconceptions about services provided by broker-dealers, investment advisers, or dual registrants that the relationship summary should specifically seek to clarify or correct?
- Would more or less information about a firm's services be helpful for retail investors? Are there any elements of the proposed requirements that firms should or should not include? If so, why? Should any of the required disclosures be included in a different section of the relationship summary? Is the proposed order of the information appropriate, or should it be modified? If so, how should it be modified? Should we allow firms the flexibility to present this information in a different order if doing so makes their relationships and services more understandable to retail investors?
- Is the proposed heading and the introductory wording for firms clear and useful to retail investors? Are there alternative headings we should consider?
- Does the mix of prescribing wording for some information and requiring brief narratives for other information strike the right balance between having similar, neutral wording to promote comparisons and permitting firms to conform the language to reflect the services they offer? Should the Commission instead require more prescribed wording in this Item? Conversely, is there prescribed wording we have proposed that we should modify or replace with a more general instruction that allows firms to use their own description?
- Does the prescribed wording we are proposing capture the range of business models of investment advisers and broker-dealers? Would the prescribed wording require any firm to state something inaccurate in the relationship summary? Should we instead provide more flexibility to change the prescribed wording?
- Should we require broker-dealers to include prescribed wording about transaction-based fees and investment advisers to state the type of fee for an advisory account at the beginning of this

[101] *Id.*

[102] *Id.*

[103] An agreement for advisory services typically defines the scope and specific types of services provided.

[104] Proposed Item 2.C.3. of Form CRS. Investment advisers would be required to emphasize the type of account (discretionary and non-discretionary) in bold and italicized font.

[105] Term 12 of Glossary of Terms to Form ADV.

[106] Proposed Item 2.C.3. of Form CRS.

[107] In 1992, only approximately three percent of SEC-registered advisers had discretionary authority over client assets; as of March 31, 2018, according to data collected on Form ADV, 91 percent of SEC-registered advisers have that authority.

[108] Proposed Item 2.C.4. of Form CRS. The required statement would be ''Our investment advice will cover a limited selection of investments. Other firms could provide advice on a wider range of choices, some of which might have lower costs.'' Also consistent with the requirements for broker-dealers, such limitations could include, for example, only offering a selection of mutual funds, equities, or proprietary products.

[109] Proposed Item 2.D. of Form CRS. This disclosure only applies in the context of an affiliate of the firm. This is not intended to describe disclosure of a financial professional's outside business activities, such as an outside investment advisory business of a broker-dealer registered representative.

section, or should fees only be discussed in the fee section?

• How should broker-dealers describe execution-only accounts, sometimes referred to as ''discount'' brokerage, and accounts in which they provide recommendations concerning securities, sometimes referred to as ''full-service'' brokerage? Should we, as proposed, require that broker-dealers offering recommendations to retail investors state that the retail investor may select investments or the broker-dealer may recommend investments, but the retail investor will make the ultimate investment decision? Should we also, as proposed, require that broker-dealers only offering discount brokerage accounts to retail investors state that the retail investor will select the investments and make the ultimate investment decision? Should we require prescribed language about these accounts, or should we permit a brief narrative as proposed? Should firms be permitted or required to use the terms ''full-service'' accounts and ''discount'' brokerage accounts, or other terms, so long as they are likely to be understood? Do investors understand the meanings of these terms?

• Should investment advisers that provide investment advisory services be required to discuss both discretionary and non-discretionary account services, regardless of whether they offer both discretionary and non-discretionary accounts? Should they instead be permitted to describe only the service they offer? Do firms offer accounts that involve limited discretionary services that would not be covered in the proposed discussions of discretionary and non-discretionary accounts? If so, how should the requirements be changed to reflect these accounts? Should we also require investment advisers to state that they offer advice on a regular basis, or, if not on a regular basis, state how frequently they offer advice? Should we require the disclosure of any additional information about the advice an investment adviser provides?

• We are proposing to require firms to disclose if they offer certain additional services, such as assistance with developing or executing the retail investor's investment strategy, and performance monitoring, and to briefly describe any regular communications they have with retail investors. Are there services in addition to those in the Instructions that broker-dealers and investment advisers also should disclose? Should we require disclosure of the same types of additional services for both broker-dealers and investment advisers?

• We understand that, to some extent, all firms limit the investments offered to retail investors. Would other disclosures regarding a firm's product offering limitations be helpful to investors, in addition to the proposed disclosures for firms that significantly limit the types of investments that are available? Why or why not? Should we, for example, require firms that only offer proprietary investments to also state that the only investments available to a retail investor are investments that the firm or its affiliates issue, sponsor, or manage? How feasible would this disclosure be for a firm that has several account types? Should we consider other alternatives?

• Is it clear what we mean by ''significantly limit'' with regard to the requirement to disclose limitations on investment choices? Should we provide additional examples or more prescriptive instructions regarding when firms must disclose such limitations? Are there other ways a firm may significantly limit the types of investments that should be captured by this instruction?

• Should we permit firms to prepare different relationship summaries for different types of services and lines of business, particularly where the firm offers a broad array of accounts and services? Would separate relationship summaries still promote comparability across firms and the ability to understand the differences between advisory and brokerage services?

• Would the proposed summary of services allow retail investors to easily compare the services provided by different firms? If not, what changes to the requirements should we make to increase comparability?

• Would other disclosures about a firm's services be more helpful for retail investors? Should we permit or require firms to describe services they offer to retail investors, in addition to brokerage and advisory services, such as insurance services? Would such disclosure about other services give retail investors a more complete overview of a firm's offerings, or would it detract from the other disclosures, for example, by overwhelming the more important information about a firm's brokerage and advisory services?

• Should we require firms to include more details about the specific services provided for each type of advisory account or brokerage account that they offer? Should the relationship summary help investors to choose among a variety of account options that the firm offers, rather than providing more summary information about the advisory and brokerage services that are offered?

• Some dual registrants have implemented a default relationship for retail investors, where, for example, the firm will act as a broker-dealer with respect to the account unless specifically stated otherwise. Should we require these firms to disclose that they are acting as a broker-dealer (or investment adviser, as applicable) with respect to the account unless the firm specifically states otherwise?

• Should we, as proposed, allow firms with affiliated broker-dealers or investment advisers to state that they offer retail investors additional brokerage or advisory services, as applicable, through their affiliates? Should we require such statements, if applicable? Should we permit or require firms to expand on the different types of services available to their retail investors through the firm's affiliates? Should affiliates be required or permitted to use a single relationship summary that describes the services of all affiliates? If not, why not? What are the advantages and disadvantages to the retail investor?

• Should we also permit or require disclosure regarding a firm's relationships with other third parties, such as where the registered representatives of a broker-dealer are also investment adviser representatives of an unaffiliated investment adviser or where an investment adviser uses a single unaffiliated broker-dealer to provide execution and custody and generally does not consider execution through other firms?

• Should we require investment advisers and broker-dealers to disclose whether they have a minimum account size and state that minimum (or range of minimums) if the account minimum varies by account? If applicable, should we require disclosure that the selection of investments or services is limited by account size? Would this help investors understand whether they are eligible for certain accounts or certain services and understand the ways in which their investment choices may be limited? Are there any drawbacks to requiring such disclosure?

• So-called robo-advisers and online broker-dealers represent a fast-growing trend within the brokerage and investment advisory industries. They employ a wide range of business models. For example, differences among robo-advisers and online broker-dealers include: The degree of reliance on computer algorithms (as opposed to individualized human judgment) to generate financial advice; the level of human interaction between the client or customer and firm personnel; and the use of the internet to communicate with clients and customers. Are the Instructions pertaining to relationships and services sufficient and appropriate to capture the business models of robo-advisers and online broker-dealers? For example, would it be appropriate to require or permit descriptions regarding the degree of human involvement in the oversight and management of individual client accounts, how computer algorithms are used in generating investment advice, and the availability of financial professionals to answer retail investors' questions? Do the requirements with respect to the content and delivery of the relationship summary, as further discussed below, allow retail investors to make informed decisions about entering into a relationship with a robo-adviser, other type of investment adviser, or broker-dealer?

3. Obligations to the Retail Investor—Standard of Conduct

Following the relationships and services section, the relationship summary would include a brief section, using prescribed wording, to describe the firm's legal standard of conduct to the retail investor.[110] The section would begin with the heading ''Our Obligations to You'' and the following language: ''We must abide by certain laws and regulations in our interactions with you.'' Firms would then use prescribed wording describing the standard of conduct applicable to investment advisers and/or broker-dealers.[111] As with certain other sections of the relationship summary, dual registrants would provide this information in tabular format to facilitate comparison.

We understand that the standard of conduct that applies to firms and financial professionals has been a source of investor confusion.[112] For example, the 913 Study noted that retail investors were not clear about the specific legal duties of broker-dealers and investment advisers.[113] We believe that providing a brief overview of the standards of conduct to which broker-dealers and investment advisers must adhere, including the differences between the standards of care of broker-dealers and investment advisers, could help alleviate this confusion. We further believe that providing this overview, in combination with the key question about the financial professional's legal obligations discussed below, would encourage a conversation between the retail investor and the financial professional about applicable legal obligations.[114] We also believe that prescribing language is appropriate to promote consistency in communicating these standards to retail investors.[115]

Broker-Dealers. We are proposing a required description of the standard of conduct for broker-dealers based on the proposed standards in Regulation Best Interest, as well as existing obligations of broker-dealers when they provide services to customers. First, a broker-dealer that provides recommendations subject to Regulation Best Interest[116] would include the following wording: ''We must act in your best interest and not place our interests ahead of yours when we recommend an investment or an investment strategy involving securities.''[117] Execution-only broker-dealers and other broker-dealers that do not provide such recommendations would not be required to include this sentence. We believe retail investors receiving recommendations that are subject to Regulation Best Interest would benefit from understanding the new obligation.

Second, all broker-dealers providing services to retail investors would state, ''When we provide any service to you, we must treat you fairly and comply with a number of specific obligations.'' This would inform retail investors that broker-dealers have a duty of fair dealing under the federal securities laws and self-regulatory organization rules, as well as other obligations and standards to which they must adhere.[118]

Finally, broker-dealers would be required to state, ''Unless we agree otherwise, we are not required to monitor your portfolio or investments on an ongoing basis.'' This sentence reflects that neither Regulation Best Interest nor existing broker-dealer standards oblige the broker-dealer to monitor the performance of retail investor's accounts,[119] while making clear that broker-dealers could agree to provide monitoring as an additional service. We are proposing this wording because we believe that the episodic, rather than ongoing, nature of broker-dealers' standard of conduct in Regulation Best Interest is a distinction from investment advisers' obligations to clients that retail investors should be

[110] Proposed Item 3.A. of Form CRS.

[111] Proposed General Instruction 1.(e) to Form CRS.

[112] *See, e.g.,* Siegel & Gale Study, *supra* note 5; and RAND Study, *supra* note 5. *See also* CFA Survey, *supra* note 5.

[113] *See* 913 Study, *supra* note 3, at v. *See also* Rand Study, *supra* note 5.

[114] *See infra* at Section II.B.8. Similarly, certain DOL regulations already obligate firms and financial professionals to acknowledge fiduciary status when they provide certain advisory type services to workplace retirement plans subject to ERISA and to IRAs. *See, e.g.,* 29 CFR 2550.408g–1(b)(7)(i)(G) (regulation under statutory exemption for participant advice requires fiduciary advisers to plans and IRAs seeking exemptive relief to provide advice and receive compensation to acknowledge fiduciary status); 29 CFR 2550.408b–2(c)(1)(iv)(B) (regulation under statutory exemption for reasonable service arrangements requires certain ERISA-covered plan service providers to state, if applicable, that the service provider will provide or reasonably expects to provide services as a ''fiduciary'' as defined by ERISA). Similarly, the DOL's BIC Exemption, *see infra* note 504, would require an investment advice fiduciary that seeks to rely on that exemption to receive compensation in connection with investment recommendations to state in writing that it is acting as a fiduciary under ERISA or the Code.

[115] As noted above, if a prescribed statement is inapplicable to a firm's business or would be misleading to a reasonable retail investor, the firm may omit or modify that statement, as further discussed below. Proposed General Instruction 3 to Form CRS. *See supra* note 58.

[116] Regulation Best Interest Proposal, *supra* note 24.

[117] Proposed Item 3.B.1. of Form CRS. This wording assumes Commission adoption of Regulation Best Interest. As noted above (*see supra* note 29 and accompanying text), the proposed definition of ''retail customer,'' to whom Regulation Best Interest would apply, differs from the proposed definition of ''retail investor'' under Form CRS. The relationship summary is intended for a broader range of investors than the intended focus of Regulation Best Interest. Accordingly, the proposed Regulation Best Interest standard may not apply to the recommendations of all retail investors receiving the relationship summary from broker-dealers. The Instructions for proposed Item 3.B.1 recognizes this possibility and seeks to ensure that broker-dealers provide accurate disclosure to their retail investors, even if the broker-dealer is not providing a recommendation subject to Regulation Best Interest.

[118] *See* Report of the Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 88–95, at 238 (1st Sess. 1963); In the Matters of Richard N. Cea, *et al.,* Exchange Act Release No. 8662 (Aug. 6, 1969), at 18 (''Release 8662'') (involving excessive trading and recommendations of speculative securities without a reasonable basis); In the Matter of Mac Robbins & Co. Inc., Exchange Act Release No. 6846 (Jul. 11, 1962). *See also* FINRA Rule 2111.01 (Suitability) (''Implicit in all member and associated person relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of [FINRA's] Rules, with particular emphasis on the requirement to deal fairly with the public. The suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct''); *see also* FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) (requiring a member, in the conduct of its business, to observe high standards of commercial honor and just and equitable principles of trade).

[119] References to ''monitoring'' relate to monitoring the performance of a portfolio or investments, and are not intended to alter or diminish broker-dealers' current supervisory obligations under the Exchange Act and detailed self-regulatory organization rules, including the establishment of policies and procedures reasonably designed to prevent and detect violations of, and to achieve compliance with, the federal securities laws and regulations, as well as applicable self-regulatory rules. *See* section 15(b)(4)(E) of the Exchange Act; FINRA Rule 3110.

aware of from the outset of a relationship.

After the description of the standard of conduct, broker-dealers would be required to state: ''Our interests can conflict with your interests.'' If the broker-dealer provides to retail investors recommendations that are subject to Regulation Best Interest, it would also include the language, ''When we provide recommendations, we must eliminate these conflicts or tell you about them and in some cases reduce them.'' [120] These statements reflect proposed requirements in Regulation Best Interest that broker-dealer would need to establish, maintain, and enforce reasonably designed policies and procedures relating to material conflicts of interest, including those arising from financial incentives, associated with recommendations to retail customers. While we are not using the exact words of the proposed standard, we believe that this information, in combination with the conflicts section below, can make the retail investor aware that conflicts exist and that the broker-dealer has obligations regarding disclosure, mitigation, or elimination of conflicts when the broker-dealer is subject to Regulation Best Interest. We believe this could help prompt a conversation between retail investors and their financial professionals about both the conflicts the firm and financial professional have and what steps the firm takes to reduce the conflicts.[121]

Investment Advisers. We propose to require that investment advisers state the standard of conduct that applies to them as an investment adviser by including the following wording: ''We are held to a fiduciary standard that covers our entire investment advisory relationship with you.'' In addition, unless the investment adviser does not provide ongoing advice (for example, provides only a one-time financial plan), the investment adviser would also state, ''For example, we are required to monitor your portfolio, investment strategy and investments on an ongoing basis.'' [122] While we are not proposing to include a specific definition of fiduciary, we believe that the proposed wording that the relationship covers the ''entire investment advisory relationship'' and wording regarding the ongoing duty to monitor would provide retail investors with information about aspects of the fiduciary duty that can help the retail investor understand the standard.[123] Additionally, as with the proposed standard of conduct disclosure for broker-dealers, we believe that the ongoing, as opposed to episodic, nature of investment advisers' standard of conduct is a distinction from broker-dealers' typical obligations when providing recommendations that retail investors should be aware of from the outset of a relationship.

After the description of the standard of conduct, investment advisers would then be required to state, ''Our interests can conflict with your interests. We must eliminate these conflicts or tell you about them in a way you can understand, so that you can decide whether or not to agree to them.'' As with broker-dealers, we believe that this information, in combination with the conflicts section below, can make retail investors aware that conflicts exist and that investment advisers, as part of their fiduciary duty, have obligations regarding conflicts.[124] We believe this could help prompt a conversation between retail investors and their financial professionals about both the conflicts the firm and financial professional have and what steps the firm takes to reduce the conflicts.

We request comment generally on the proposed standard of conduct descriptions, and in particular on the following issues:

- Should we require, as proposed, that all firms include a brief prescribed statement about the legal standards of conduct that apply to them under the federal securities laws, including the new standard proposed in Regulation Best Interest and an investment adviser's fiduciary duty? Is such disclosure likely to be meaningful to retail investors? Does the prescribed wording capture what retail investors should or want to understand about broker-dealers' and investment advisers' standards of conduct? Would the prescribed wording require any firm to provide any inaccurate information? Are there modifications to the proposed wording or alternative wording that would make the legal standards more clear in a succinct way? Should we require or permit additional information, and if so, what? Alternatively, would a briefer statement be appropriate? Are there any common misconceptions about broker-dealers' and investment advisers' standard of conduct that the relationship summary should specifically seek to clarify or correct?
- Should we require or permit broker-dealers to include additional detail about the best interest standard proposed in Regulation Best Interest or their duty of fair dealing? Would this or other disclosure provide retail investors with useful information? Should we provide flexibility in how broker-dealers describe the best interest standard or duty of fair dealing?
- We are proposing to require that broker-dealers state that they must comply with a number of specific obligations when providing any service to customers. Should we permit or require more detailed disclosure about these obligations? For example, should we permit or require broker-dealers to disclose their obligations to make sure that the prices a customer receives when a trade is executed are fair and reasonable, and to make sure that the commissions and fees the customer pays are not excessive?
- Should we require disclosure that further describes the investment adviser fiduciary standard, including any additional details described in the proposed interpretation? If so, what wording should we require? Should we provide flexibility in describing the fiduciary standard?
- For dual registrants, would the side-by-side descriptions of the standards of conduct for broker-dealers and investment advisers assist retail investors in understanding the differences between these standards? Are there modifications we can make to the wording or the presentation to facilitate this comparison?
- Should we permit or require firms to disclose additional information about the legal differences between broker-dealers and investment advisers, such as explaining that broker-dealers are subject to regulation by self-regulatory organizations in addition to the SEC? Should we permit or require firms to disclose the differences in licensing requirements for financial professionals of broker-dealers and investment advisers, such as the frequency of licensing or qualifications examinations? Would such disclosure about financial professionals fit within this section of the relationship summary that focuses on the firm? What information would be most relevant to retail investors?

[120] Proposed Item 3.B.2. of Form CRS. This wording assumes Commission adoption of the Regulation Best Interest.

[121] *See* discussion of the proposed conflicts of interest disclosure in the relationship summary, *infra* Section II.B.6.

[122] Proposed Item 3.C.1. of Form CRS.

[123] We are concurrently publishing for comment a proposed interpretation of the standard of conduct for investment advisers under the Advisers Act. *See* Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, Investment Advisers Act Release No. IA–4889 (Apr. 18, 2018) (''Fiduciary Duty Interpretive Release'').

[124] *See, e.g.,* General Instruction 3 to Form ADV, Part 2.

• We understand that state laws and other regulations,[125] also may require broker-dealers and advisers to affirmatively acknowledge fiduciary status. Should we provide firms flexibility to include language in a relationship summary consistent with or to satisfy these other regulatory requirements? Would such flexibility enhance or potentially reduce the effectiveness of the relationship summary?

4. Summary of Fees and Costs

We are proposing to require broker-dealers and investment advisers to include an overview of specified types of fees and expenses that retail investors will pay in connection with their brokerage and investment advisory accounts. This section would include a description of the principal type of fees that the firm will charge retail investors as compensation for the firm's advisory or brokerage services, including whether the firm's fees vary and are negotiable, and the key factors that would help a reasonable retail investor understand the fees that he or she is likely to pay.[126] Investment advisers that provide advice to retail investors about investing in "wrap fee programs" would include an overview of the fees associated with those wrap fee programs.[127] Both broker-dealers and investment advisers would state that some investments impose fees that will reduce the value of a retail investor's investment over time, and would provide examples relevant to the firm's business.[128] In addition, each firm would include the incentives it and its financial professionals have to put their own interests ahead of their retail investors' interests based on the account fee structure,[129] and would state that depending on an investor's investment strategy, retail investors may prefer paying a different type of fee in certain specified circumstances.[130] Having a clear, simple explanation of the fees a retail investor would pay firms for advisory accounts versus brokerage accounts, and the incentives that such fees create, would help the retail investor to understand the types of fees that they will pay and make a more informed choice about which account is right for them. As with other sections of the relationship summary, dual registrants would provide this information in tabular format to facilitate comparison.[131]

Fees and costs are important to retail investors,[132] but many retail investors are uncertain about the fees they will pay.[133] Many commenters have stressed the importance of clear fee disclosure to retail investors, including disclosure about differences between advisory and brokerage fees.[134] Accordingly, the proposed relationship summary is intended to provide investors greater clarity concerning certain categories of fees they should expect to pay, how the types of fees affect the incentives of the firm and their financial professionals, and certain other fees and expenses that will reduce the value of the retail investor's investment. The proposed relationship summary would focus on certain general types of fees, rather than describe all fees or provide a comprehensive schedule of fees. Specifically, the proposal would highlight certain differences in how broker-dealers and investment advisers charge for their services.

We are not proposing a requirement that firms personalize the fee disclosure for their retail customers, or provide a comprehensive fee schedule, as some commenters had proposed.[135] A personalized fee disclosure could be expensive and complex for firms to provide in a standardized presentation across all of their accounts and in a way that captures all fees, including embedded fees in various investments (which will vary for each investor depending on their portfolio). Many firms likely would seek to implement systems to automate the disclosure for each of their existing and prospective retail investors, and if such systems were expensive, some firms could choose to reduce the products and services that they offer as a result of the additional costs. Our proposal would encourage retail investors to ask financial professionals about their fees and request personalized information about the specific fees and expenses associated with their current or prospective accounts. As further discussed in Section II.B.8 below, one of the proposed questions for a retail investor to ask a financial professional is to "do the math for me," and specifically encourages retail investors to ask about the amount that they would pay per year for the account, what would make the fees more or less, and the services included in those fees.[136] Additionally, the beginning of the Fees and Costs section of the relationship summary would state: "Please ask your financial professional to give you personalized information on fees and

[125] *See. e.g., supra* note 114.

[126] Proposed Item 4 of Form CRS. A broker-dealer would describe transaction-based fees as its principal type of fee, using prescribed wording. *See* proposed Item 4.B.1 of Form CRS. We use the term "transaction-based fees" in the relationship summary for plain language purposes to refer generally to broker-dealer compensation such as commissions, mark-ups, mark-downs, sales loads or similar fees, including 12b–1 fees, tied to specific transactions. An investment adviser would summarize the principal fees and costs that align with the type of fee(s) the adviser reports in response to Item 5.E. of Form ADV Part 1A that are applicable to retail investors. *See* proposed Item 4.C. of Form CRS. Investment advisers and associated persons that receive compensation in connection with the purchase or sale of securities should carefully consider the applicability of the broker-dealer registration requirements of the Exchange Act.

[127] Proposed Items 4.C.3., 4.C.7., 4.C.9. and 4.C.10. of Form CRS.

[128] Proposed Items 4.B.2.b. and 4.C.4. of Form CRS.

[129] Proposed Items 4.B.5. and 4.C.8. of Form CRS.

[130] Proposed Items 4.B.6. and 4.C.10. of Form CRS. Dual registrants would make these disclosures under the heading "Fees and Costs," whereas standalone investment advisers and broker-dealers would make certain of these disclosures under the heading "Fees and Costs," and certain of these disclosures under the heading, as applicable "Compare with Brokerage Accounts" or "Compare with Advisory Accounts," as described below. Proposed Items 5.A.4. and 5.B.6. of Form CRS.

[131] Proposed General Instruction 1.(e) to Form CRS.

[132] *See* 917 Financial Literacy Study, *supra* note 20, at iv ("With respect to financial intermediaries, investors consider information about fees, disciplinary history, investment strategy, conflicts of interest to be absolutely essential.").

[133] *See* Rand Study, *supra* note 5, at xix ("In fact, focus-group participants with investments acknowledged uncertainty about the fees they pay for their investments, and survey responses also indicate confusion about the fees."). In addition, we have brought enforcement actions against advisers providing inaccurate disclosure of all of the fees and costs that retail investors pay. *See, e.g.,* In the Matter of Robert W. Baird & Co. Inc., Investment Advisers Act Release No. 4526 (Sept. 8, 2016) (settled action) ("In re Robert W. Baird"); In the Matter of Raymond James & Associates, Inc., Investment Advisers Act Release No. 4525 (Sept. 8, 2016) (settled action) ("In re Raymond James"); In the Matter of Barclays Capital Inc., Investment Advisers Act Release No. 3929 (Sep. 23, 2014) (settled action) ("Release 3929").

[134] *See, e.g.,* Kiley 2017 Letter (recommending that investors receive disclosures about the differences in advisory and brokerage fees, and brokers' specific fee and commission structure); Stifel 2017 Letter (recommending that firms explain the differences between brokerage and advisory accounts with the goal of improving understanding of a firm's different service models, compensation arrangements, and conflicts of interests); Equity Dealers of America 2017 Letter (recommending disclosure of aspects of advisory and brokerage accounts, including the type of fees charged, to facilitate investors' selection of an account type); Wells Fargo 2017 Letter; ACLI 2017 Letter; FSR 2017 Letter; SIFMA 2017 Letter; UBS 2017 Letter; Comment letter of the Investment Company Institute (Aug. 7, 2017) ("ICI 2017 Letter"); State Farm 2017 Letter; IAA 2017 Letter; Bernardi Securities 2017 Letter; Fidelity 2017 Letter; Vanguard 2017 Letter.

[135] *See, e.g.,* Comment letter of Mark J. Flannery, BankAmerica Professor of Finance, University of Florida (Jul. 27, 2017) ("Flannery 2017 Letter"); Pefin 2017 Letter (recommending that clients should receive information on a quarterly basis on fees charged to their account, the calculation used to determine fees, and a breakdown of the charges by category).

[136] *See infra* Section II.B.8.; *infra* notes 299–303 and accompanying text; proposed Item 8 of Form CRS.

costs that you will pay.'' [137] We believe that financial professionals are well positioned to provide individualized fee information to their retail investors upon request. During the account opening process, for example, generally the relevant financial professional would have access to personalized information about the retail investor's account and can put together personalized fee information estimates during the process.

Likewise, we believe that requiring a comprehensive fee schedule in the relationship summary also could be more complex than a retail investor would find useful for an overview disclosure such as this. However, we believe our proposed layered disclosure would achieve similar results in a less costly and complex manner. The relationship summary would provide required information about fees, and a later section titled ''Additional Information'' would provide references and links to other disclosures where interested investors can find more detailed information.[138] As discussed below, investment advisers would be required to direct retail investors to additional information in the firm's Form ADV Part 2 brochure and any brochure supplement provided by a financial professional to the retail investor.[139] An adviser's Form ADV Part 2 contains more detailed information about the firm's fees. Broker-dealers would likewise be required to direct retail investors to additional information at BrokerCheck, the firm's website, and the retail investor's account agreement.[140] Up-to-date fee disclosures may appear on broker-dealers' websites or in the retail investors' account agreements, if applicable, where we understand broker-dealers typically provide information about fees, including, in some cases, comprehensive fee schedules.[141]

We are also not proposing to require firms to include examples of how fees could affect a retail investor's investment returns. We recognize that the Commission has required firms to disclose examples showing the effects of fees and other costs in certain contexts. For example, we have required mutual funds to provide in their summary prospectuses an example that is intended to help investors compare the cost of investing in the mutual fund with the cost of investing in other mutual funds.[142] While we continue to believe that examples of the effect of fees on returns could be helpful to retail investors, they could also fail to capture the effect of a firm's fees on a particular retail investor's account. Transactional fees, in particular, can vary widely based on a number of circumstances, and it could be potentially misleading to present a typical example showing how sample transaction fees apply to a sample account over time. We believe requiring firms to provide an example for each type of account that would show the effect of fees on a sample account could overwhelm investors due to the number and variability of assumptions that would need to incorporated, explained, and understood in order for the example to be meaningful, and would not necessarily promote comparability. If the assumptions were standardized, such examples might not be useful, or might even be potentially misleading, to the retail investor, whose circumstances may be different from the assumptions used.

Some commenters suggested requiring that a firm disclose the types of compensation firms and their financial professionals receive, including from third parties, in connection with providing investment recommendations.[143] A few commenters suggested requiring disclosure of how much the firm and its financial professionals receive in fees, including commissions and fees from third parties.[144] We agree with commenters that it is important to make investors aware of such fees and compensation because they create conflicts of interest for firms and financial professionals making investment recommendations for retail investors. We are proposing to require that firms disclose commissions and certain third-party fees related to mutual funds in this section, and certain compensation-related conflicts (*e.g.,* conflicts related to revenue sharing) in the conflicts section of the relationship summary, as discussed in Section II.B.6 below.

Heading. To emphasize the importance of fees, all firms would be required to include the following statement at the beginning of this section under the heading ''Fees and Costs'': ''Fees and costs affect the value of your account over time. Please ask your financial professional to give you personalized information on the fees and costs that you will pay.'' [145] We are proposing this precise wording because we believe it is applicable to retail investors regardless of any differences among the accounts and their fees. Understanding that fees and costs affect investment value over time would help retail investors to understand why they should review and understand this information. This introductory language also would highlight that retail investors could get more personalized information from the firm's financial professionals.

Brokerage Account Fees and Costs. Broker-dealers would be required to summarize the principal fees and costs that retail investors will incur.[146] First, we are proposing prescribed language that describes the transactional nature of many brokerage fees.[147] We are proposing different wording for dual registrants than for standalone broker-dealers to facilitate the side-by-side comparison with the description of the advisory fee in the dual registrant's relationship summary. Specifically, dual registrants that offer retail investors both investment advisory accounts and brokerage accounts would include the following wording to assist with the side-by-side comparison with investment advisers: ''*Transaction-based fees.* You will pay us a fee every time you buy or sell an investment. This fee, commonly referred to as a commission, is based on the specific transaction and not the value of your account.'' [148] A standalone broker-dealer

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[137] Proposed Item 4.A. of Form CRS.

[138] Proposed Item 7 of Form CRS.

[139] Proposed Item 7.E.2. of Form CRS. Investment advisers that do not have a public firm website or do not maintain their current Form ADV brochure on its public website would be required to include a link to *adviserinfo.sec.gov*. Advisers that do not have a public firm website would also be required to include a toll-free telephone number where retail investors can request up-to-date information.

[140] Proposed Item 7.E.1. of Form CRS. Broker-dealers that do not have a public firm website would be required to include a toll-free telephone number where retail investors can request up-to-date information.

[141] Under Regulation Best Interest, broker-dealers would also be required to disclose the material facts relating to the scope and terms of the relationship, which would include disclosure of fees and charges that apply to a customer's transactions, holdings and accounts. Regulation Best Interest Proposal, *supra* note 24, at section II.D.1.a.

[142] *See* Item 3 of Mutual Fund Summary Prospectus; Enhanced Mutual Fund Disclosure Adopting Release, *supra* note 47, at section III.A.3.b (''The fee table and example are designed to help investors understand the costs of investing in a fund and compare those costs with the costs of other funds.'').

[143] *See, e.g.,* SIFMA 2017 Letter; UBS 2017 Letter; ICI 2017 Letter; State Farm 2017 Letter; Bernardi Securities 2017 Letter; Fidelity 2017 Letter.

[144] *See, e.g.,* Flannery 2017 Letter; Pefin 2017 Letter.

[145] Proposed Item 4.A. of Form CRS.

[146] Proposed Item 4.B. of Form CRS.

[147] As discussed above, we use the term ''transaction-based fees'' to refer to broker-dealer compensation such as commissions, mark-ups, mark-downs, sales loads or similar fees, including 12b–1 fees, tied to specific transactions. *See supra* note 126.

[148] Proposed Item 4.B.1. of Form CRS. As discussed further below, dual registrants would include a parallel statement regarding their investment advisory account fees. Proposed Item 4.C.1. of Form CRS.

would include the following: ''The fee you pay is based on the specific transaction and not the value of your account.'' [149]

In addition, both standalone and dual registrant broker-dealers would include the following (emphasis required): ''With stocks or exchange-traded funds, this fee is usually a separate commission. With other investments, such as bonds, this fee might be part of the price you pay for the investment (called a ''*mark-up*'' or ''*mark down*''). With mutual funds, this fee (typically called a ''*load*'') reduces the value of your investment.'' [150] Because of the importance of these transaction-based fees to brokerage services, as well as the variety of forms that such fees can take, we believe it will benefit investors to have specific examples to illustrate transaction-based fees with standardized, concise wording. We are proposing to require the example of mutual fund loads because they are common indirect fees associated with investments that compensate the broker-dealer.

We are not proposing to require broker-dealers to provide the range of their transaction-based fees. We understand that these fees vary widely based on the specific circumstances of a transaction. For example, a broker-dealer that transacts in only one type of security—such as equities—can have a wide range of transaction fees for such securities, depending on factors such as the size of the transaction, the type of investment purchased, the type of account and services provided, and how retail investors place their orders (for example, online, telephone or with the assistance of a financial professional). A broker-dealer that transacts in multiple types of securities—for example, equities and real estate investment trusts (REITs)—could have an even wider range of transaction fees. Given this variability, and our intent that the relationship summary be short and that it be provided in addition to, and not in lieu of, other disclosure, we believe that requiring firms to provide a range of transaction-based fees in the relationship summary could be confusing or provide limited benefit to retail investors.

Following the examples of transaction-based fees, broker-dealers would be required to state that some investments impose additional fees that will reduce the value of retail investors' investments over time, and provide examples of such investments that they offer to retail investors.[151] Mutual funds, variable annuities and exchange-traded funds are common examples, as well as any other investment that incurs fund management, 12b–1, custodial or transfer agent fees, or any other fees and expenses that reduce the value of the investment over time.[152] Broker-dealers also would be required to state that a retail investor could be required to pay fees when certain investments are sold, for example, surrender charges for selling variable annuities.[153] We believe that it is important to highlight for investors the costs associated with particular investments in addition to describing the transaction-based fee for brokerage services. Retail investors may not appreciate that they will bear costs for some investments in addition to the transaction-based brokerage fee they pay to their financial professional or firm.[154] In addition, the investment fees and expenses we are proposing to require that firms disclose are ones that we believe are among the most common and can have a substantial impact on an investor's return from a particular investment.

Requiring the disclosure of these investment fees and expenses, sometimes described as ''indirect fees,'' follows commenters' recommendations that investment advisers and broker-dealers disclose certain indirect costs to retail investors.[155] We are not proposing a requirement that firms disclose the amount or range of mutual fund fees or other third-party fees that retail investors may pay related to their underlying investments, as a few commenters recommended.[156] These expenses vary so greatly that attempts to quantify them or describe their range likely would not be useful to retail investors or would provide limited benefit to retail investors given that the relationship summary is designed to be short disclosure provided in addition to, and not in lieu of, other disclosures.[157] Instead, we intend that our proposed summary disclosure would effectively highlight these costs in a simple, understandable way.

Additionally, broker-dealers would be required to state whether or not the fees they charge retail investors for their brokerage accounts vary and are negotiable, including a description of the key factors that they believe would help a reasonable retail investor understand the fee that he or she is likely to pay for the firm's services.[158] Such factors could include, for example, how much the retail investor buys or sells, what type of investment the retail investor buys or sells, and what kind of account the retail investor has with the broker-dealer. We believe investors would benefit from knowing at account opening whether they have the ability to negotiate the fees they pay.

Broker-dealers would next be required to state, if applicable, that a retail investor will also pay other fees in addition to the firm's transaction-based fee, and to list those fees, including account maintenance fees, account inactivity fees, and custodian fees.[159] We believe that it is important to highlight for investors the fees associated with an account that they will pay in addition to the principal type of fee that the firm charges retail investors for their brokerage account because these fees are common and they can have an impact on a retail investor's return.

Broker-dealers would then be required to disclose certain specified incentives they have to put their own interests ahead of retail investors' interests based on charging transaction-based fees for brokerage accounts.[160]

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[149] Proposed Item 4.B.1. of Form CRS. As discussed above, standalone broker-dealers would be required to include wording that a transaction-based fee is generally referred to as a commission in the Relationships and Services section of the relationship summary. *See* proposed Item 2.B.1. of Form CRS.

[150] Proposed Item 4.B.2.a. of Form CRS.

[151] Proposed Item 4.B.2.b. of Form CRS. Investment advisers would also be required to make this disclosure. *See* proposed Item 4.C.4. of Form CRS.

[152] We acknowledge that some fees, such as 12b–1 fees, could be a broker-dealer's principal fee for their brokerage services and are also fees that reduce the return on an investment. In such a case, the broker-dealer would describe transaction-based fees as its principal fees and costs pursuant to proposed Item 4.B.1, and would also describe these fees as additional fees that will reduce the return on an investor's investments pursuant to proposed Item 4.B.2.b. of Form CRS.

[153] Proposed Item 4.B.2.b. of Form CRS. Investment advisers would also be required to make this disclosure. *See* proposed Item 4.C.4. of Form CRS.

[154] *See, e.g.,* Enhanced Disclosure and New Prospectus Delivery Option For Registered Open-End Management Investment Companies, Investment Company Act Release No. 28064 (Nov. 21, 2007) [72 FR 67790 (Nov. 30, 2007)], at n.49 and accompanying text (''In recent years, we have taken significant steps to address concerns that investors do not understand that they pay ongoing costs every year when they invest in mutual funds, including requiring disclosure of ongoing costs in shareholder reports.'').

[155] *See, e.g.,* State Farm 2017 Letter; Bernardi Securities 2017 Letter; Pefin 2017 Letter; Flannery 2017 Letter; Comment letter of Dan Keppel (Jun. 5, 2017); Comment letter of Edward H. Weyler (Jun. 8, 2017).

[156] *See* Flannery 2017 Letter; Pefin 2017 Letter.

[157] *See* Amendments to Form ADV, Investment Advisers Act Release No. 3060 (Jul. 28, 2010) [75 FR 49233 (Aug. 12, 2010)] (''Brochure Adopting Release''); Amendments to Form ADV, Investment Advisers Act Release No. 2711 (Mar. 3, 2008) [73 FR 13958 (Mar. 14, 2008)] (''2008 Brochure Proposing Release'').

[158] Proposed Item 4.B.3. of Form CRS.

[159] Proposed Item 4.B.4. of Form CRS.

[160] Proposed Item 4.B.5. of Form CRS.

They would be required to include the following: ''The more transactions in your account, the more fees we charge you. We therefore have an incentive to encourage you to engage in transactions.'' [161] We believe this information would help retail investors understand how the fee structures for brokerage accounts could affect their investments and the incentives that firms and financial professionals have to place their interests ahead of retail investors' interests by encouraging retail investors to engage in transactions to increase their fees.[162] We are proposing to prescribe wording because we believe these particular incentives and considerations generally apply to most brokers that offer retail investors brokerage accounts, and using uniform wording would promote consistency. We believe that retail investors would benefit from understanding these incentives when they are considering broker-dealers. Additionally, we believe this disclosure would reinforce a key theme of the relationship summary, which is choice across account types and services.

Finally, dual registrants would be required to include the following with respect to brokerage services: ''From a cost perspective, you may prefer a transaction-based fee if you do not trade often or if you plan to buy and hold investments for longer periods of time.'' [163] We believe that these factors—cost, trading frequency, and the desire to ''buy and hold''—are important for retail investors to consider when determining whether to use brokerage services or advisory services.[164] We are proposing to prescribe the wording because we believe these factors reflect common circumstances in which a brokerage account could be more cost-effective for a retail investor than an advisory account, and using uniform wording would promote consistency. We believe this disclosure, in conjunction with the corresponding disclosure regarding advisory accounts that would appear next to it, would help retail investors to compare the two services and make an informed choice about the account type that is the right fit for them based on their goals and preferences.

Investment Advisory Account Fees and Costs. Investment advisers that offer advisory accounts to retail investors would be required to summarize the principal fees and costs that retail investors will incur.[165] Dual registrants that charge ongoing asset-based fees for their advisory services would state the following: ''*Asset-based fees.* You will pay an on-going fee [at the end of each quarter] based on the value of the cash and investments in your advisory account.'' [166] replacing, as needed, the bracketed wording with how often they assess the fee. If the dual registrant charges another type of fee for advisory services, it would briefly describe that fee and how often it is assessed.[167] Standalone investment advisers would state the following: ''The amount paid to our firm and your financial professional generally does not vary based on the type of investments we select on your behalf.'' [168] Standalone investment advisers that charge an ongoing asset-based fee would also state ''The asset-based fee reduces the value of your account and will be deducted from your account.'' [169] Standalone investment advisers that charge another type of fee would succinctly describe how the fee is assessed and the impact it has on the value of the retail investor's account.[170]

These requirements are consistent with the current fee disclosure requirements for the Form ADV brochure and how investment advisers typically describe asset-based fees, and we believe that retail investors would find this type of disclosure helpful.[171] We are not proposing to require that investment advisers provide the range of fees, as ranges an investment adviser charges can vary based on a number of factors individual to the retail investor and the services they choose. Additionally, although we do not believe that ranges for investment advisers' asset based fees vary as much as broker-dealers' transaction-based fees, we recognize that requiring firms to provide a fee range for advisory accounts and not brokerage accounts could cause confusion among retail investors and be of limited benefit when comparing advisory and brokerage services. However, we recognize that providing such a range could promote comparability between different advisers, and we request comment below on whether we should require disclosure of the adviser's range of principal fees charged.

An investment adviser that provides advice to retail investors about investing in a wrap fee program would be required to include specified language about the program fees.[172] A ''wrap fee program'' would be defined as an advisory program that charges a specified fee not based directly upon transactions in the account for investment advisory services and the execution of transactions.[173] The advisory services may include portfolio management or advice concerning selection of other advisers.[174] An

[161] *Id.*

[162] Pursuant to the federal securities laws, broker-dealers can violate the federal antifraud provisions by engaging in excessive trading that amounts to churning, switching, or unsuitable recommendations. Churning occurs when a broker-dealer, exercising control over the volume and frequency of trading in a customer account, abuses the customer's confidence for personal gain by initiating transactions that are excessive in view of the character of the account and the customer's investment objectives. Excessive trading is an excessive level of trading unjustified in light of the customer's investment objectives. *See Mihara* v. *Dean Witter & Co., Inc.,* 619 F.2d 814, 821 (9th Cir. 1980); *Carras* v. *Burns,* 516 F.2d 251, 258 (4th Cir. 1975). *See also* Regulation Best Interest Proposal, *supra* note 24, at section II.D.2.c.

[163] Proposed Item 4.B.6. of Form CRS.

[164] *See e.g.,* Comment letter of The Capital Group Companies, Inc. (Mar. 12, 2018) (discussing considerations for buy and hold investors choosing among commission-based and fee-based arrangements). Standalone broker-dealers and standalone investment advisers would also be required to include similar wording under the headings ''Compare with Typical Advisory Accounts'' and ''Compare with Typical Brokerage Accounts,'' as applicable. *See* proposed Items 5.B.5 and 5.A.4 of Form CRS. Dual-registrants, standalone broker-dealers, and standalone investment advisers would also be required to include a statement that retail investors may prefer an asset-based fee in certain circumstances, and that an asset-based fee may cost more than a transaction-based fee. *See* proposed Items 4.C.10, 5.B.5 and 5.A.4 of Form CRS.

[165] Proposed Item 4.C. of Form CRS. An investment adviser would summarize the principal fees and costs that align with the type of fee(s) the adviser reports in response to Item 5.E. of Form ADV Part 1A that are applicable to retail investors.

[166] Proposed Item 4.C.1. of Form CRS.

[167] *Id.* Some investment advisers report on Form ADV Item 5.E that they receive ''commissions.'' These ''commissions'' may include deferred sales loads, including fees for marketing and service, as well as commissions as understood in the broker-dealer context. As a form of deferred sales load, all payments of ongoing sales charges to intermediaries would constitute transaction-based compensation. Intermediaries receiving those payments should consider whether they need to register as broker-dealers under section 15 of the Exchange Act.

[168] Proposed Item 4.C.2. of Form CRS. We recognize that, in some cases, the amount paid to the advisory firm and the financial professional can vary based on the type of investment selected (*e.g.,* advisory firms and financial professionals may recommend certain mutual funds that pay the adviser or the financial professional 12b–1 fees out of fund assets).

[169] *Id.*

[170] Proposed Item 4.C.2. of Form CRS. Investment advisers that offer retail investors advisory accounts sometimes charge fees that are not ongoing, asset based fees. A financial planner, for example, sometimes charges a one-time fixed fee to prepare a plan.

[171] As discussed above, when completing Form CRS, investment advisers should generally consider achieving consistency with the type(s) of fee(s) that the investment adviser reports on Item 5.E. of Form ADV Part 1A. *See supra* note 126.

[172] Proposed Items 4.C.3., 4.C.6., 4.C.9. and 4.C.10. of Form CRS. We also refer to these types of investment advisers as ''client-facing firms.''

[173] Proposed General Instruction 9.(g) to Form CRS. This proposed definition is identical to the definition already used in Form ADV.

[174] Proposed General Instruction 9.(g) to Form CRS.

investment adviser that provides advice to retail investors about investing in a wrap fee program and does not also offer another type of advisory account would be required to include the following (emphasis required): ''We offer advisory account programs called *wrap fee programs.* In a *wrap fee program,* the asset-based fee will include most transaction costs and fees to a broker-dealer or bank that will hold your assets (known as ''*custody*''), and as a result wrap fees are typically higher than non-wrap advisory fees.'' [175] An investment adviser that provides advice about investing in a wrap fee program and offers another type of advisory account would be required to include similar prescribed wording, modified as applicable to reflect that the adviser also offers other types of advisory accounts.[176]

Many retail investors participate in wrap fee programs.[177] We believe that retail investors would benefit from receiving information about certain characteristics of wrap fee programs, particularly with respect to their fees. Requiring investment advisers to describe the asset-based fee, what it includes, and that it is typically higher than non-wrap advisory fees would help a retail investor to distinguish wrap fee programs from other types of advisory accounts that charge or incur separate transaction fees.

Next, investment advisers would be required to state that some investments impose additional fees that will reduce the value of a retail investor's investment over time, and provide examples of such investments that the firm offers to retail investors.[178] Investment advisers also would state that a retail investor could be required to pay fees when certain investments are sold, for example, surrender charges for selling variable annuities.[179] These proposed requirements are identical to the disclosure that broker-dealers would provide.[180]

In addition, investment advisers would be required to state whether or not the fees they charge retail investors for their advisory accounts vary and are negotiable.[181] They would be required to describe the key factors that they believe would help a reasonable retail investor understand the fee that he or she is likely to pay for the firm's services.[182] Such factors could include, for example, the services the retail investor receives and the amount of assets in the account. As discussed above with regard to broker-dealers, we believe investors would benefit from knowing at account opening whether they have the ability to negotiate the fees they pay.

Investment advisers would next be required to state, if applicable, that a retail investor will pay transaction-based fees when the firm buys and sells an investment for the retail investor (*e.g.,* commissions paid to broker-dealers for buying or selling investments) in addition to the firm's principal fee it charges retail investors for the firm's advisory accounts.[183] Investment advisers would also be required to state, if applicable, that a retail investor will pay fees to a broker-dealer or bank that will hold the retail investor's assets and that this is called ''custody,'' and would be required to list other fees the retail investor will pay.[184] Examples could include fees for account maintenance services. These other fees we are proposing to require firms to disclose are ones that we believe are among the most common or can have an impact on a retail investor's return.[185] As discussed above, we believe that investors would benefit from being aware of the fees associated with an account that they will pay in addition to the principal fee that the firm charges retail investors for their brokerage or advisory account.

An investment adviser that provides advice to retail investors about investing in a wrap fee program also would be required to state: ''Although transaction fees are usually included in the wrap program fee, sometimes you will pay an additional transaction fee (for investments bought and sold outside the wrap fee program).'' [186] The Commission is aware that wrap fee program portfolio managers employ, to varying degrees, ''trading away'' practices, in which they use a broker other than the sponsoring broker to execute trades for which a commission or other transaction-based fee is charged, in addition to the wrap fee, to the retail investor.[187] The Commission has identified instances in which firms participating in wrap fee programs had poor disclosure about the overall cost of selecting a wrap fee program, including the effect of their trade away practices.[188] We believe that investors would benefit from the relationship summary highlighting that, even in a wrap fee program, they sometimes will pay an additional transaction fee.

As with broker-dealers, investment advisers that charge an ongoing asset-based fee for advisory services would next be required to address the incentives they have to put their own interests ahead of their retail investors' interests based on the type of fee charged for investment advisory services.[189] These advisers would be required to include the following statement: ''The more assets you have in the advisory account, including cash, the more you will pay us. We therefore have an incentive to increase the assets in your account in order to increase our fees. You pay our fee [insert frequency of fee (*e.g.,* quarterly)] even if you do not

[175] Proposed Item 4.C.3. of Form CRS. The asset-based fee in a wrap program does not always include all transaction costs. For example, in some cases retail investors pay mark-ups, mark-downs, or spreads, and mutual fund fees and expenses in addition to the wrap fee program's asset-based fee. In addition, as discussed below, an investment adviser may select a broker-dealer outside of the wrap fee program to execute certain trades in a retail investor's account—a practice sometimes referred to as ''trading away''—that results in the retail investor's account incurring separate brokerage fees. *See infra* note 187 and accompanying text.

[176] Such investment advisers would be required to include the following (emphasis required): ''For some advisory accounts, known as *wrap fee programs,* the asset-based fee will include most transaction costs and custody services, and as a result wrap fees are typically higher than non-wrap advisory fees.'' Proposed Item 4.C.3. of Form CRS.

[177] Based on IARD data as of December 31, 2017, of the 12,667 SEC-registered investment advisers, 1,035 (8.17%) sponsor a wrap fee program, and 1,597 (12.61%) act as a portfolio manager for one or more wrap fee programs.

[178] Proposed Item 4.C.4 of Form CRS. *See supra* notes 151–155 and accompanying text for a discussion of this requirement applicable to both investment advisers and broker-dealers.

[179] Proposed Item 4.C.4. of Form CRS.

[180] *See* proposed Item 4.B.2.b. of Form CRS.

[181] Proposed Item 4.C.5. of Form CRS.

[182] *Id.*

[183] Proposed Item 4.C.6. of Form CRS.

[184] *Id.*

[185] *See, e.g.,* Advisers Act rule 204–3; Item 5 of Form ADV Part 2A (requiring each adviser to describe the types of other costs, such as brokerage, custody fees and fund expenses that clients may pay in connection with the advisory services provided to them by the adviser).

[186] Proposed Item 4.C.7. of Form CRS.

[187] A wrap fee program portfolio manager may trade away because, for example, it believes that doing so will allow it to seek best execution of clients' transactions, as investment advisers have an obligation to seek best execution of clients' securities transactions where they have the responsibility to select broker-dealers to execute client trades (typically in the case of discretionary accounts). *See* Advisers Act rule 206(3)–2(c) (referring to adviser's duty of best execution of client transactions). *See also* Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 54165 (Jul. 18, 2006) (stating that investment advisers have ''best execution obligations'') (''Release 54165''). *See also* Brochure Adopting Release at 9.

[188] The Commission has brought enforcement actions in these circumstances. *See, e.g.,* In re Robert W. Baird, *supra* note 133; In re Raymond James, *supra* note 133; In the Matter of Riverfront Investment Group, LLC, Investment Advisers Act Release No. 4453 (Jul. 14, 2016) (settled action); In the Matter of Stifel, Nicolaus & Company, Inc., Investment Advisers Act Release No. 4665 (Mar. 13, 2017) (settled action).

[189] Proposed Item 4.C.8. of Form CRS.

buy or sell,'' replacing the brackets with the frequency of their fee.[190] Investment advisers that provide advice to retail investors about participating in a wrap fee program would, in addition, be required to include the following: ''Paying for a wrap fee program could cost more than separately paying for advice and for transactions if there are infrequent trades in your account.'' [191] We are proposing to require prescribed wording to promote consistency and because we believe these particular incentives and considerations generally apply to all advisers that charge retail investors ongoing asset-based fees or provide advice about participating in a wrap fee program. While we are not proposing any prescribed language for other fee types, such as fixed fees, we request comment, below, on whether advisers that charge other types of fees for their advisory services have incentives to act in their own interest based on the type of fee charged, and whether we should require disclosure of such incentives.

These disclosures would help retail investors understand how the fee structures for advisory accounts could affect their investments and the incentives that firms and financial professionals have to place their interests ahead of retail investors' interests. The disclosures for investment advisers that provide advice about investing in a wrap fee program also would help retail investors to understand that in certain circumstances a wrap fee would cost them more than separately paying for advice and for transactions in a different type of advisory account. Similarly, wrap fee sponsors that complete the Form ADV Wrap Fee Program Brochure are required to explain that the wrap fee program may cost the client more or less than purchasing such services separately and describe the factors that bear upon the relative cost of the program, such as the cost of the services if provided separately and the trading activity in the client's account.[192] As with some of the proposed requirements described above, we are proposing to prescribe wording because we believe these particular considerations generally apply to any investment in a wrap fee program and would promote consistency. Also, as discussed above, we believe this disclosure would reinforce a key theme of the relationship summary, which is choice across account types and services.

Finally, dual registrants that charge ongoing asset-based fees for advisory accounts would be required to include the following with respect to their investment advisory services: ''An asset-based fee may cost more than a transaction-based fee, but you may prefer an asset-based fee if you want continuing advice or want someone to make investment decisions for you.'' [193] Dual registrants that provide advice to retail investors about investing in wrap fee programs would also be required to include the following with respect to wrap fee program accounts: ''You may prefer a wrap fee program if you prefer the certainty of a [insert frequency of the wrap fee (*e.g.,* quarterly)] fee regardless of the number of transactions you have.'' [194] We believe that these features—ongoing advice, discretion, standards of conduct, and, for wrap fee programs, certainty in pricing—distinguish advisory accounts and wrap fee programs from brokerage accounts. We also believe it is important to highlight how costs relate to the services included.[195] We are proposing to prescribe wording because we believe these particular considerations generally apply to all advisory accounts and wrap fee programs, and using uniform wording would promote consistency. We believe these disclosures, in conjunction with the corresponding disclosure regarding broker-dealer accounts that would appear next to it for dual registrants, would help retail investors to compare the two types of services and combinations of those services and make an informed choice about the account type that is the right fit for them based on their goals and preferences.

We request comment generally on the proposed fees and costs disclosures, and in particular on the following issues:

• Is the proposed disclosure discussing fees and expenses useful to investors?

• Do the proposed requirements encourage disclosure that is simple, clear and useful to retail investors? Would the proposed disclosure help investors to understand and compare the fees and costs associated with a firm's advisory services and brokerage services? Are there any revisions to the descriptions of fees that would make the proposed disclosure more useful to investors? Is it clear that retail investors would incur different costs for different types of accounts and advice services? Are there common assumptions or misconceptions regarding account fees and services that firms should be required to discuss, clarify, or address?

• Is the proposed order of the information appropriate, or should it be modified? If so, how should it be modified?

• Do the proposed requirements strike the right balance between requiring specific wording and allowing firms to draft their own responses? Why or why not? Should the Commission permit or require a more open-ended narrative or require more prescribed wording? Do the proposed Instructions cover the range of business models and fee structures that investment advisers and broker-dealers offer fully and accurately? Are there other fees that should be required to be disclosed for broker-dealers or investment advisers?

• Is the proposed format useful for retail investors to understand and compare fees and costs as between broker-dealers and investment advisers? Should we require further use of bullet points, tables, charts, graphs or other illustrative format? Should we require, as proposed, that dual registrants present the fee and cost information in a tabular format, comparing advisory services and brokerage services side-by-side, or permit other formats such as in a bulleted format?

• How would the required disclosures contribute to readability and length of the proposed relationship summary? Should each of these disclosures be required? Should any of these disclosures not be required but instead permitted? Should any of these disclosures be required to appear in the relationship summary, but outside the proposed summary of fees and costs?

• Should any additional disclosures about fees and costs be included for investment advisers? In particular, should we require any disclosures from an investment adviser's Form ADV Part 2A narrative brochure, such as more details about an investment adviser's fees? Some other disclosures about fees that are included in Form ADV Part 2A, but that we have not included in the proposed relationship summary, include an adviser's fee schedule; whether the adviser bills clients or

[190] Proposed Item 4.C.8. of Form CRS.

[191] Proposed Item 4.C.9. of Form CRS.

[192] *See* Item 4.B. of Form ADV Part 2A; Appendix 1 of Form ADV: *Wrap Fee Program Brochure.*

[193] Proposed Item 4.C.10. of Form CRS. Standalone investment advisers and standalone broker-dealers would also be required to include similar wording under the headings ''Compare with Typical Brokerage Based Accounts,'' and ''Compare with Typical Advisory Accounts,'' as applicable. Proposed Items 5.A.4 and 5.B.5. of Form CRS.

[194] Proposed Item 4.C.10. of Form CRS.

[195] We also propose to require dual registrants to include the following with respect to broker-dealer services: ''From a cost perspective, you may prefer a transaction-based fee if you do not trade often or if you plan to buy and hold investments for longer periods of time.'' *See* proposed Items 4.B.6. *See also* Items 5.A.4. and 5.B.5 of Form CRS (including similar disclosures to be made by standalone investment advisers and broker-dealers).

deducts fees directly from clients' accounts; and an explanation of how an adviser calculates and refunds prepaid fees when a client contract terminates (for an adviser charging fees in advance). Should we require some or all of such disclosures, or other disclosures about fees?

• Should we require or permit advisers to disclose whether they charge performance-based fees, which is a type of compensation investment advisers may charge to "qualified clients," that is based on a share of capital gains on, or capital appreciation of, such clients' assets?[196] Advisers are required to disclose their receipt of performance-based fees on Form ADV, and they provide an incentive for the adviser to take additional investment risks with the account.

• Should we permit or require each firm to provide the range of its fees? If so, should broker-dealers be required to include a range for each type of transaction-based fee it charges or the aggregate range for all of the firm's transaction-based fees? Should investment advisers be required to include a range for each type of principal fee they charge retail investors for advisory services, or the aggregate range for all of its principal advisory fees? Do broker-dealers and investment advisers currently compute or have the ability to compute such aggregated fee information? What factors determine the type or amount of fee that firms charge (*e.g.,* for broker-dealers, such factors could include the: means of placing an order, such as online, by telephone or in person; type of account, such as full-service or discount brokerage, and; type of product)? Do commenters have suggestions for how best to convey one or more ranges in a space-limited disclosure in light of the different fee structures? Are there other ways to give retail investors a better sense of the amount of fees they will pay without providing account-specific disclosures?

• Should we require firms to state whether their fees are "negotiable," as we have proposed? At firms that offer negotiable fees, are retail investors generally able to negotiate their fees, and if not, would they find this disclosure helpful or could it be confusing? Will firms be able to succinctly describe the key factors they believe would help a reasonable retail investor understand the fee that he or she is likely to pay for a firm's services (*e.g.,* the size of the transaction, the type of investment purchased, and the type of account and services he or she receives)?

[196] *See* Advisers Act rule 205–3.

• Will any of the required disclosures be misleading or make it more difficult for investors to select the right type of account for them?

• Should we make the proposed relationship summary more personalized to individual retail investors, such as by requiring or permitting estimates for each retail investor, reflecting the fees and charges incurred for the retail investor's brokerage or advisory account? Is personalization feasible for this type of relationship summary disclosure? If so, what information should be included in the personalized fees and cost disclosure, and how should such information be presented? How would firms calculate those estimates? How often should we require firms to update the personalized fees and compensation disclosure, and how should the personalized fee disclosure updates be delivered or made available to retail investors? What would be the costs to firms to prepare and update personalized fee and compensation disclosures?

• Should we require firms to provide investors with personalized fee information in a different disclosure, such as an account statement? What would be the cost and benefits, including the costs of books and records requirements, of personalizing information to investors relative to the proposal? Do firms currently provide retail investors with personalized fee disclosure estimates at or before account opening? Do they provide personalized fee disclosures in periodic account statements? For firms that provide personalized fee disclosures, do they include all fees paid by the retail investor as well as compensation received by the firm and financial professionals, even if such compensation is not paid directly or indirectly by the retail investor, such as commissions, mark-ups, mark-downs, other fees embedded in the investment or fees from third parties? What other types of fee information do firms include? Do they automate such disclosures? How expensive and complex a process is creating and delivering such personalized fee disclosures?

• Should we require firms to state where retail investors can find personalized information about account fees and costs, such as on account statements and trade confirmations? What other source of such information might be available for prospective customers and clients? Should we require firms to include hyperlinks to fee and cost calculators on *investor.gov*?

• Should we require firms to provide an example showing how sample fees and charges apply to a hypothetical advisory account and a hypothetical brokerage account, as applicable? Should we require a more general example that shows the impact of hypothetical fees on an account? If so, what assumptions should we require firms to make in preparing such an example? For example, should we specify assumptions such as the kinds of assets that are most typical for a broker-dealer's customers, stated commission schedules, and aggregate third-party compensation? If the assumptions were standardized, would such examples be useful to the retail investor, whose circumstances may be different from the assumptions used or would they help give an investor a better idea about what kind of fees are being charged? Would such examples provide retail investors with a clear understanding of the application of ongoing asset-based, transaction-based and product-level fees to an account? Should we require one example for an advisory account and one example for a brokerage account? How should the information be presented (*e.g.,* mandated graphical presentation)? Should we require firms to present more than one hypothetical example showing a range of fees instead (*e.g.,* based on representative holdings or recommendations)? Should specific assumptions be included in calculating the hypothetical example? What disclosures would need to accompany the example? Should the example(s) track the effect of the fees over time, and if so, over what time period (*e.g.,* over one, five and 10 years)? Or should firms describe the impact of different amounts or types of fees over a longer period of time, such as 20 years?

• Should firms be permitted or required to include in the relationship summary a detailed fee table or schedule? Should we permit or require firms to create a fee schedule as separate disclosure, and then include it as an attachment (or cross reference it with a website address and hyperlink) to the relationship summary? What should be included in such a fee table or schedule? Should it include compensation received by the firm and financial professionals, even if such compensation is not paid directly or indirectly by the retail investor, such as commissions or fees from third parties?

• Regarding fees related to funds and other investments that reduce the value of the investment over time, would the required disclosures by investment advisers and broker-dealers be clear and understandable to retail investors?

Should we, as proposed, permit firms to select their own example that they offer to retail investors? Are there other considerations related to fees for funds and other investments that we should require firms to highlight for retail investors? Would our proposed requirement that firms disclose the existence of such fees, along with examples of investments that impose such fees, adequately inform retail investors of these costs? Should we require an example showing how investment fees and expenses and other account fees and expenses may affect a retail investor's investment over time? Should we require a reference to such an example if available elsewhere (*e.g.,* in mutual fund, ETF or variable annuity prospectuses)?

• Should firms describe the types of compensation they and their financial professionals receive from sources other than the retail investor in the description of their conflicts of interest, as we have proposed (for example, with respect to revenue sharing arrangements, such as payments for ''shelf space,'' *i.e.,* product distribution by broker-dealers)? Or, should we require firms to state in the fees and costs section of the relationship summary that they and their financial professionals receive such compensation? If so, what types of additional compensation should we require firms to disclose in the summary of fees and costs? Should we require firms to disclose how the amount of fees received from retail investors relates to the amount of fees received from others in connection with recommendations or other services to those investors? Would such disclosure be confusing to retail investors? Should we require firms only to disclose which source of fees is greater or to provide a reasonable estimate of the relative magnitude of the categories of such fees (*e.g.,* that on average for retail customers that the amount the firm receives from third parties is twice as much as the firm charges investors)?

• Should we require firms to state, as proposed, that a retail investor will also pay other fees in addition to the firm's principal fee for brokerage or advisory services, and to list such fees? Should we also require firms to state ranges for such fees?

• We are proposing disclosures that are intended to help retail investors understand how the principal types of fees firms charge for advisory and brokerage accounts affect the incentives of the firm and their financial professionals. Are these disclosures clear? Do they capture all incentives that broker-dealers or investment advisers may have from their fee structures? Are there other considerations related to fees and compensation that we should require firms to highlight for retail investors that are not captured here or elsewhere in the relationship summary? Should we require firms to include the prescribed wording, as proposed, or should we allow more flexibility in the words they use? Should we modify the prescribed wording? For example, should we expressly permit or require broker-dealers to modify the prescribed wording regarding their incentive to encourage retail investors to engage in transactions, to the extent they also receive compensation that might lower such incentive, such as asset-based compensation (*e.g.,* rule 12b–1 fees, sub-transfer agent or other similar service fees)?

• For our prescribed wording for investment advisers regarding the adviser's incentive to increase the assets in a retail investor's advisory account, would different wording better reflect this incentive? Does the proposed wording capture the conflict of interest, or does the wording suggest that advisers will increase retail investors' assets by generating higher investment returns? Because many advisers do not charge ongoing asset-based fees as their principal fees for retail investor advisory accounts, and instead charge fixed fees, hourly fees, commissions or other types of fees, should we require these firms to state the incentives they have as a result of receiving such other types of fees? If so, what are the incentives that such firms have that are important for retail investors to understand and would be relevant to the relationship summary?

• These proposed disclosures about a firm's incentives can also be considered to involve conflicts, as they address the incentives that investment advisers and broker-dealers have as a result of receiving certain types of fees. Should we require this disclosure in the conflicts of interest disclosure instead of the summary of fees and costs? Should we require firms to include in the summary of fees and costs any other fee-related conflicts that we propose to include in the conflicts of interest disclosure, as discussed in Section II.B.6 below? Should we require firms to include other fee-related conflicts in these sections that are not included elsewhere in the relationship summary?

• Would our proposed disclosure for advisers and broker-dealers, that retail investors may, in certain circumstances, prefer one type of fee over another, be useful to retail investors? Are these proposed disclosures clear? Do they adequately capture the typical circumstances in which retail investors would prefer one fee type over another? Are there other considerations related to fees and compensation that we should require or permit firms to highlight for retail investors that are not captured here or elsewhere in the relationship summary? Should we require firms to include the prescribed wording, as proposed, or should we allow more flexibility in the words they use? Should we modify the prescribed wording? Does the proposed prescribed wording capture the range of business models among investment advisers and broker-dealers? Would the prescribed wording require a firm to provide any inaccurate information given that particular firm's circumstances?

• Should we require firms to make disclosures about wrap fee programs, as proposed? Would the proposed disclosures help investors to understand the fees and costs associated with a wrap fee program as compared to unbundled advisory accounts and brokerage accounts? Would the proposed disclosures help retail investors to make informed choices about whether a wrap fee program suits their needs, as compared with unbundled investment advisory or brokerage services? If not, how could we revise it? Are there any revisions to the descriptions of wrap fee programs that would make the proposed disclosures more useful to investors?

• Are there other differences between wrap fee programs, unbundled advisory accounts, and brokerage accounts that we should require firms to include, such as other differences in fees and services? Would more or less information about wrap fee programs be helpful for retail investors? For instance, should we require firms to disclose information about the firms that participate in the wrap fee programs they recommend (e.g., the wrap fee program sponsors or managers), and any particular conflicts relevant to investors in wrap fee programs? Should we require more or less disclosure, or different disclosure, about the amount and frequency of additional transaction fees retail investors incur in wrap fee programs? Are there any elements of the proposed requirements that we should exclude? If so, why? Should any of the required disclosures be included in a different section of or an appendix to the relationship summary?

• Have we appropriately tailored the information required for advisers that provide advice about investing in both a wrap fee and a non-wrap fee program, and advisers that only provide advice about investing in a wrap fee program?

Should we require firms that provide advice about investing in both a wrap fee and a non-wrap fee program to prepare a separate relationship summary for the wrap fee program? Should we instead require firms to prepare an appendix with information about the wrap fee program, in addition to the relationship summary, as we do for the Form ADV brochure? If so, what types of information should we require firms to include about wrap fee programs in a separate relationship summary or appendix, and why should we require such disclosure?

• Should we require broker-dealers that sponsor wrap fee programs to include any additional disclosures about wrap fee programs, other than the disclosures that would be made by dual registrants?

• We understand that client-facing firms—or advisers that provide advice to retail investors about investing in wrap fee programs—are not necessarily the same firms that sponsor wrap fee programs (we define a wrap fee program sponsor in Form ADV General Instructions as a firm that sponsors, organizes, or administers the program or selects, or provides advice to clients regarding the selection of, other investment advisers in the program). Should we require each client-facing firm to include the proposed wrap fee disclosures in its relationship summary, even if the firm is not the wrap fee program sponsor, as proposed? Please describe how this information is currently provided to wrap fee program clients.

• Should we require only sponsors of wrap fee programs (and not all client-facing firms) to include the proposed wrap fee disclosures in the relationship summary, similar to the Form ADV wrap fee brochure delivery requirement, which requires only investment advisers that sponsor wrap fee programs to deliver to their wrap fee clients the Form ADV wrap fee brochure? If so, should we permit only one sponsor of a wrap fee program that has multiple sponsors to include the proposed wrap fee disclosures in the relationship summary, similar to the delivery requirements for the Form ADV wrap fee brochure?

• In addition to wrap fee programs, are there other types of retail investor programs and services for which it would be useful to require investment advisers and broker-dealers to disclose additional information about the nature and scope of services, fees and conflicts of interest? If so, which programs and services, and why should we require such disclosure?

• Are there any common misconceptions about broker-dealers' and investment advisers' compensation that the relationship summary should specifically seek to clarify or correct (*e.g.,* that the firm or financial professional will only be compensated if the retail investor makes money on the investment)?

5. Comparisons

We are proposing to require standalone investment advisers and standalone broker-dealers to prepare this section under the following headings: ''Compare with Typical Brokerage Accounts'' (for standalone investment advisers) or ''Compare with Typical Advisory Accounts'' (for standalone broker-dealers).[197] Specifically, standalone broker-dealers would include the following information about a generalized retail investment adviser: (i) The principal type of fee for investment advisory services; (ii) services investment advisers generally provide, (iii) advisers' standard of conduct; and (iv) certain incentives advisers have based on the investment adviser's asset-based fee structure.[198] For investment advisers, this section would include parallel categories of information regarding broker-dealers.[199]

We are proposing to require these disclosures to help retail investors choose among different account types and services. Having a clear explanation of differences in the fees, scope of services, standard of conduct, and incentives that are generally relevant to advisory and brokerage accounts would help retail investors that are considering one such type of relationship to compare whether their needs might be better met with the other type of relationship. In addition, we are proposing to prescribe wording in this section because it is intended to provide a general comparison of what we believe is a typical brokerage or investment adviser account that is offered to retail investors. Moreover, we believe prescribing language will promote uniformity and allow retail investors to receive the same information to use in comparing choices from different standalone firms.

Standalone investment advisers would be required to include the following prescribed language (emphasis required): ''You could also open a brokerage account with a *broker-dealer,* where you will pay a *transaction-based fee,* generally referred to as a commission, when the broker-dealer buys or sells an investment for you.'' [200] They would be required to include prescribed statements in bullet point format (except as otherwise specified) under the lead-in ''Features of a typical brokerage account include:'' [201] First, there would be a general description of brokerage accounts: ''With a broker-dealer, you may select investments or the broker-dealer may recommend investments for your account, but the ultimate decision as to your investment strategy and the purchase and sale of investments will be yours.'' [202] This statement would highlight for the retail investor two aspects of a typical broker-dealer's services that differ from that of an investment adviser—specifically, that an investor may select investments without advice or he or she may receive recommendations from the broker-dealer, and that the investor will make the ultimate investment decision.

Standalone investment advisers would then include the following information about the standard of conduct applicable to broker-dealers: ''A broker-dealer must act in your best interest and not place its interests ahead of yours when the broker-dealer recommends an investment or an investment strategy involving securities. When a broker-dealer provides any service to you, the broker-dealer must treat you fairly and comply with a number of specific obligations. Unless you and the broker-dealer agree otherwise, the broker-dealer is not

[197] Proposed Items 5.A. and 5.B. of Form CRS. As discussed above, for purposes of the relationship summary, we propose to define a standalone investment adviser as a registered investment adviser that offers services to retail investors and (i) is not dually registered as a broker-dealer or (ii) is dually registered as a broker-dealer but does not offer services to retail investors as a broker-dealer. We propose to define a standalone broker-dealer as a registered broker-dealer that offers services to retail investors and (i) is not dually registered as an investment adviser or (ii) is dually registered as an investment adviser but does not offer services to retail investors as an investment adviser. Proposed General Instruction 9.(f) to Form CRS. *See supra* note 51. A dually registered firm that offers retail investors only advisory or brokerage services (but not both) may in the future decide to offer retail investors both services. We would expect a firm to update its relationship summary within 30 days whenever any information in the relationship summary becomes materially inaccurate. *See* proposed General Instruction 6.(a). to Form CRS and *infra* note 350 and accompanying text. In addition, the firm would communicate the information in its amended relationship summary to retail investors who are existing clients or customers of the firm within 30 days after the updates are required to be made and without charge. *See* proposed General Instruction 6.(b) to Form CRS and *infra* note 354 and accompanying text.

[198] Proposed Item 5.B. of Form CRS.

[199] Proposed Item 5.A. of Form CRS.

[200] *Id.*

[201] *Id.*

[202] Proposed Item 5.A.1. of Form CRS.

required to monitor your portfolio or investments on an ongoing basis.'' [203] As discussed above in Section II.B.3, above, the applicable standard of conduct for financial professionals has been a source of confusion among retail investors. This statement would provide information to retail investors about the obligations of broker-dealers, including some differences from investment advisers' obligations so that they can consider this factor when determining whether brokerage services might better suit their needs.

Standalone investment advisers would then include the following statement discussing incentives created by a typical broker-dealer's fee: ''If you were to pay a transaction-based fee in a brokerage account, the more trades in your account, the more fees the broker-dealer charges you. So it has an incentive to encourage you to trade often.'' [204] This disclosure is substantially similar to the disclosure we propose a broker-dealer would be required to include in the ''Fees and Costs'' section of its relationship summary.[205] As discussed above, we believe this information would help retail investors understand how the fee structures for brokerage accounts could affect their investments, which they could compare with the incentives advisers have based on their fee structure.[206]

Finally, a tabular chart would compare certain specified characteristics of a transaction-based fee and an ongoing asset-based fee side-by-side, set off by the wording ''You can receive advice in either type of account, but you may prefer paying:'' [207] One column would include the following (emphasis required): ''*a transaction-based fee* from a cost perspective, if you do not trade often or if you plan to buy and hold investments for longer periods of time.'' [208] The other column would include the following (emphasis required): ''*an asset-based fee* if you want continuing advice or want someone to make investment decisions for you, even though it may cost more than a transaction-based fee.'' [209] This disclosure is substantially similar to the disclosure we propose that each dual registrant would include in the ''Fees and Costs'' section of its relationship summary.[210] For the reasons discussed above, we are proposing this requirement to encourage choice across account types and services.[211] We are also proposing that advisers include this information in the specified side-by-side manner in order to promote comparisons between the relevant considerations for both types of relationships.

Standalone broker-dealers would be required to include the following prescribed language (emphasis required), which would highlight for the retail investor the different fee structure of many investment advisers: ''You could also open an advisory account with an *investment adviser,* where you will pay an ongoing *asset-based fee* that is based on the value of the cash and investments in your advisory account.'' [212] Standalone broker-dealers would list prescribed statements describing certain differences from investment advisers in bullet point format (except as otherwise specified) under the lead-in ''Features of a typical advisory account include:''.[213] First, there would be a general description of investment advisory accounts as follows: ''Advisers provide advice on a regular basis. They discuss your investment goals, design with you a strategy to achieve your investment goals, and regularly monitor your account.'' [214] The next bullet would highlight that investment advisers offer discretionary accounts and non-discretionary accounts by including the following (emphasis included): ''You can choose an account that allows the adviser to buy and sell investments in your account without asking you in advance (a ''*discretionary account*'') or the adviser may give you advice and you decide what investments to buy and sell (a ''*non-discretionary account*'').'' [215] Together, these statements would highlight for the retail investor two aspects of a typical investment adviser's services that differ from the typical services of a broker-dealer—specifically, ongoing advice and monitoring and discretionary accounts.

Standalone broker-dealers would then include the following disclosure about an investment adviser's standard of conduct: ''Advisers are held to a fiduciary standard that covers the entire relationship. For example, advisers are required to monitor your portfolio, investment strategy and investments on an ongoing basis.'' [216] As discussed above, the applicable standard of conduct for financial professionals has been a source of confusion among retail investors. This statement would provide information to retail investors about the obligations of investment advisers so that they can consider this factor when determining whether investment advisory services might better suit their needs.

Standalone broker-dealers would then include the following disclosure about a typical investment advisory asset-based fee, as follows: ''If you were to pay an asset-based fee in an advisory account, you would pay the fee periodically, even if you do not buy or sell.'' [217] They would also be required to include the following prescribed disclosure about hourly fees and one-time flat fees, which are common among investment advisers that offer financial planning services and other advisory services to retail investors: ''You may also choose to work with an investment adviser who provides investment advice for an hourly fee, or provides a financial plan for a one-time fee.'' [218]

The next statement would note certain incentives created by an investment adviser's ongoing asset-based fee. Broker-dealers would include the following: ''For an adviser that charges an asset-based fee, the more assets you have in an advisory account, including cash, the more you will pay the adviser. So the adviser has an incentive to increase the assets in your account in order to increase its fees.'' [219] This statement is substantially similar to the disclosure an investment adviser would be required to include in the ''Fees and Costs'' section of its relationship summary.[220] For the reasons discussed above, we believe this information would help retail investors understand how the principal fee structures for typical advisory accounts could affect their investments and the incentives financial professionals may have based on charging ongoing asset-based fees for investment advisory services. This proposed disclosure would encourage retail investors to compare these incentives with certain incentives broker-dealers have based on their fee structure, which broker-dealers

[203] Proposed Item 5.A.2. of Form CRS.

[204] Proposed Item 5.A.3. of Form CRS.

[205] *See supra* Section II.B.4.

[206] *Id.*

[207] Proposed Item 5.A.4. of Form CRS.

[208] *Id.*

[209] *Id.*

[210] *See supra* Section II.B.4.

[211] *Id.*

[212] Proposed Item 5.B. of Form CRS. We recognize that some investment advisers charge other types of fees for their advisory services, including fixed fees for one-time services such as financial planning. However, because asset-based fees are a common type of fee for advisory services, we think it would be useful for firms to describe asset-based fees in this section of the relationship summary for comparison with broker-dealers' transaction-based fees.

[213] Proposed Item 5.B. of Form CRS.

[214] Proposed Item 5.B.1. of Form CRS.

[215] Proposed Item 5.B.2. of Form CRS.

[216] Proposed Item 5.B.3. of Form CRS.

[217] Proposed Item 5.B.4. of Form CRS.

[218] *Id.*

[219] Proposed Item 5.B.5. of Form CRS.

[220] *See supra* Section II.B.4.

would describe under ''Fees and Costs.'' [221]

Finally, standalone broker-dealers would be required to include the same tabular chart that standalone investment advisers would include.[222] As discussed above, requiring this information side-by-side would promote comparisons of typical advisory and brokerage relationships.

We request comment generally on the proposed comparison disclosures to be provided by standalone investment advisers and broker-dealers, and in particular on the following issues:

• Is it useful to require firms to include disclosures about services and fees they do not offer, so that investors know other choices are available and are better able to compare different types of firms?

• Is it clear from the headings that the information provided in this section describes a typical investment adviser and broker-dealer, and does not describe the circumstances of all investment advisers and broker-dealers? Why or why not? Should we modify the headings or provide additional information at the beginning of this section?

• Do the proposed requirements encourage disclosure that is simple, clear, and useful to retail investors? Would the proposed disclosure help investors to understand and compare the fees, services and standard of conduct associated with a firm's advisory services and brokerage services? Are there any revisions to the descriptions of fees, services, standard of conduct, and incentives that would make the proposed disclosure more useful to investors?

• Is the proposed order of the information appropriate, or should it be modified? If so, how should it be modified?

• Is the proposed disclosure about how often a typical advisory firm monitors retail investors' accounts useful to retail investors, given that different firms may view ''ongoing monitoring'' differently?

• Is the proposed format useful for retail investors to understand and compare fees, services, standard of conduct and incentives among broker-dealers and investment advisers? Should we permit or require further use of tables, charts, graphs or other graphics or text features?

• Should we require firms to include the prescribed wording, as proposed, or should we allow more flexibility in the words they use? Does the proposed prescribed wording capture the range of typical business models and fee structures that investment advisers and broker-dealers offer? Would the prescribed wording require a firm to provide any inaccurate information given that particular firm's circumstances? If so, how should it be modified? Instead of the proposed prescriptive wording, should the Commission permit or require a more open-ended narrative?

• How would the required explanations and various disclosures contribute to readability and length of the proposed relationship summary? Should each of these explanations be required, permitted, or prohibited? Should any of these explanations be required to appear in the relationship summary, but outside the comparisons section?

• Are there other considerations related to investment advisers and broker-dealers that we should require or permit firms to highlight for retail investors? For example, should we require advisers to state that broker-dealers sometimes offer both full-service and discount brokerage accounts, and the differences between them, including fees? Are there any disclosures that we should omit?

• Is the proposed prescriptive wording describing the standard of conduct required for investment advisers and broker-dealers clear and useful to retail investors? Would the proposed disclosure help investors to understand the standard of conduct associated with a firm's advisory services and brokerage services? Should such disclosure be modified? If so, how should it be modified?

• Should we amend the proposed wording that describes the standard of conduct for broker-dealers to incorporate or refer to any fiduciary obligations that certain broker-dealers have under state law or other laws or regulations?

• Our proposal would require a standalone investment adviser to include prescribed disclosure about a broker-dealer's incentives based on a typical broker-dealer's principal fee structure, and vice versa. Should these disclosures be substantially similar to the disclosures we propose certain dual registrants to include, as proposed? [223] Or should we modify these disclosures for firms that do not offer retail investors both brokerage and advisory services? If so, how should these disclosures be modified?

• Our proposal would require a standalone investment adviser and a standalone broker-dealer to include prescribed disclosure that a retail investor may prefer one type of fee over another in certain circumstances. Should these disclosures be substantially similar to the disclosures we propose certain dual registrants to include, as proposed? Or should we modify these disclosures for firms that do not offer retail investors both brokerage and advisory services? If so, how should these disclosures be modified?

6. Conflicts of Interest

We are proposing to require that investment advisers and broker-dealers summarize their conflicts of interest related to certain financial incentives. Specifically, firms would be required to disclose conflicts relating to: (i) Financial incentives to offer to, or recommend that the retail investor invest in, certain investments because (a) they are issued, sponsored or managed by the firm or its affiliates, (b) third parties compensate the firm when it recommends or sells the investments, or (c) both; (ii) financial incentives to offer to, or recommend that the retail investor invest in, certain investments because the manager or sponsor of those investments or another third party (such as an intermediary) shares revenue it earns on those products with the firm; and (iii) the firm buying investments from and selling investments to a retail investor for the firm's own account (*i.e.*, principal trading).[224]

Investment advisers, broker-dealers, and their financial professionals have incentives to put their interests ahead of the interests of their retail investor clients and customers. The federal securities laws do not preclude broker-dealers or investment advisers from having conflicts of interest that might adversely affect the objectivity of the advice they provide; however, firms and financial professionals have obligations regarding their conflicts. Investment advisers are required to eliminate, or, at a minimum, fully and fairly disclose conflicts of interest clearly enough for a client to make an informed decision to consent to such conflicts and practices,

[221] *Id.*

[222] Proposed Item 5.B.6. of Form CRS.

[223] *See supra* Section II.B.4.

[224] Proposed Item 6 of Form CRS. Studies have shown, for example, that for broker-dealers, the most frequently identified disclosures concerned issues of compensation—*e.g.*, how clients compensate the firm, how other firms compensate it, and how employees are compensated. *See, e.g.*, Rand Study, *supra* note 5, at xviii. We sometimes refer interchangeably to payments, compensation and benefits that firms and financial professionals receive. These terms are all meant to capture the various ways through which firms and financial professionals have financial incentives to favor a product, service, account type, investor, or provider over another.

or reject them.[225] For broker-dealers, the federal securities laws and rules and self-regulatory organization rules address broker-dealer conflicts in one (or more) of the following ways: Express prohibitions,[226] mitigation,[227] or disclosure.[228] Under Regulation Best Interest, broker-dealers would be required to establish, maintain and enforce written policies and procedures reasonably designed to identify and disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with such recommendation,[229] as well as to disclose, in writing, all material conflicts of interest that are associated with the recommendation.[230]

Conflicts of interest with retail investors often arise when firms and/or their financial professionals recommend or sell proprietary products or products offered by third parties, recommend products that have revenue sharing arrangements, and engage in principal trading.[231] For example, a firm could have a financial incentive to recommend proprietary products because the firm (or its affiliate) would receive additional revenue or an affiliate could pay a firm for recommending affiliate products. A broker-dealer making a platform available for self-directed transactions may select investments available for purchase on the platform based on financial incentives the broker-dealer receives. Similarly, a financial professional could be paid for recommending affiliated products or could get a bonus or greater promotion potential for recommending certain investments.[232] These conflicts create an incentive for firms and their financial professionals to make available for sale or base investment recommendations on the compensation or profit that firms will receive, rather than on the client's best interests.[233] The Commission's enforcement actions underscore how these types of compensation arrangements and activities may produce conflicts of interest that can lead firms and their financial professionals to act in their own interests, rather than the interests of their retail investors.[234]

We are not proposing to require or permit the relationship summary disclosure to include specific information about all of the conflicts of interests that are or could be present in a firm's relationship with retail investors. For example, conflicts that can be applicable to investment advisers include using certain affiliated service providers,[235] charging performance-based fees to some accounts but not others,[236] personal trading by an adviser's personnel,[237] receipt of soft dollar products and services provided by brokers in connection with client transactions,[238] and voting client securities.[239] Likewise, a broker-dealer

[225] *See SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 194 (1963) (An adviser must deal fairly with clients and prospective clients, seek to avoid conflicts with its clients and, at a minimum, make full disclosure of any material conflict or potential conflict.); *see also* Instruction 3 of General Instructions to Part 2 of Form ADV. *See* Fiduciary Duty Interpretive Release, *supra* note 123.

[226] For example, FINRA rules establish restrictions on the use of non-cash compensation in connection with the sale and distribution of mutual funds, variable annuities, direct participation program securities, public offerings of debt and equity securities, and real estate investment trust programs. These rules generally limit the manner in which members can pay for or accept non-cash compensation and detail the types of non-cash compensation that are permissible. *See* FINRA Rules 2310, 2320, 2341, and 5110.

[227] *See, e.g.,* FINRA Rule 3110(c)(3) (firm must have procedures to prevent the effectiveness of an internal inspection from being compromised due to conflicts of interest); FINRA Rule 3110(b)(6)(C) (supervisory personnel generally cannot supervise their own activities); FINRA Rule 3110(b)(6)(D) (firm must have procedures reasonably designed to prevent the required supervisory system from being compromised due to conflicts of interest).

[228] For example, when engaging in transactions directly with customers on a principal basis, a broker-dealer violates Exchange Act rule 10b–5 when it knowingly or recklessly sells a security to a customer at a price not reasonably related to the prevailing market price and charges excessive mark-ups, without disclosing the fact to the customer. *See, e.g., Grandon* v. *Merrill Lynch & Co.,* 147 F.3d 184, 189–90 (2d. Cir. 1998). *See also* Exchange Act rule 10b–10 (requiring a broker-dealer effecting transactions in securities to provide written notice to the customer of certain information specific to the transaction at or before completion of the transaction, including the capacity in which the broker-dealer is acting (*i.e.,* agent or principal) and any third party remuneration it has received or will receive.

[229] Broker-dealers would also be required to establish, maintain, and enforce written policies and procedures reasonably designed to identify and at a minimum disclose, or eliminate, all material conflicts of interest that are associated with such recommendation. *See* Regulation Best Interest Proposal, supra note 24, section II.D.3.

[230] *See* Regulation Best Interest Proposal, supra note 24, section II.D.1.

[231] *See, e.g.,* Rand Study, *supra* note 5, at 13 (''Examples of such conflicts include various practices in which an adviser may have pecuniary interest (through, *e.g.,* fees or profits generated in another commercial relationship, finder's fees, outside commissions or bonuses) in recommending a transaction to a client.'') and 15 (noting that the formation of the Committee on Compensation Practices was, in part, motivated by concerns that commission-based compensation may encourage registered representatives to churn accounts or make unsuitable recommendations).

[232] Jason Zweig & Anne Tergesen, *Advisers at Leading Discount Brokers Win Bonuses to Push Higher-Priced Products,* Wall Street Journal (Jan. 10, 2018), *available at https://www.wsj.com/articles/advisers-at-leading-discount-brokers-win-bonuses-to-push-higher-priced-products-1515604130.*

[233] *See, e.g.,* Brochure Adopting Release, *supra* note 157, at n.62 and accompanying text and n.132; Report of the Committee on Compensation Practices (Apr. 10, 1995), at 3, *available at https://www.sec.gov/news/studies/bkrcomp.txt* (''The prevailing commission-based compensation system inevitably leads to conflicts of interest among the parties involved.''). *See also* FINRA Report on Conflicts of Interest (Oct. 2013), *available at https://www.finra.org/sites/default/files/Industry/p359971.pdf* (discussing conflicts of interest in the broker-dealer industry and highlighting effective conflicts management practices); *SEC* v. *Capital Gains Research Bureau Inc.,* 375 U.S. at 191, 196–97 (''The Investment Advisers Act of 1940 thus reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship. . . . An investor seeking the advice of a registered investment adviser must, if the legislative purpose is to be served, be permitted to evaluate such overlapping motivations, through appropriate disclosure, in deciding whether the adviser is serving two masters or only one, especially if one happens to be economic self-interest.''); In the Matter of Feeley & Willcox Asset Management Corp., Investment Advisers Act Release No. 2143 (Jul. 10, 2003) (Commission opinion) (''It is the client, not the adviser, who is entitled to make the determination whether to waive the adviser's conflict. Of course, if the adviser does not disclose the conflict, the client has no opportunity to evaluate, much less waive, the conflict.'').

[234] *See infra* notes 243, 255, 256, 260 and 267, citing examples of where we have brought enforcement actions regarding conflicts of interest arising from one or more of the following categories of compensation practices and activities: the compensation of the firm's financial professionals; payments from others; incentives for selling the firm's own products, and principal trading.

[235] Item 10.C. of Form ADV Part 2A. Item 10 requires an investment adviser to describe in its brochure material relationships or arrangements the adviser (or any of its management persons) has with related financial industry participants, any material conflicts of interest that these relationships or arrangements create, and how the adviser addresses the conflicts. The disclosure that Item 10 requires highlights for clients their adviser's other financial industry activities and affiliations that can create conflicts of interest and may impair the objectivity of the adviser's investment advice. *See* Brochure Adopting Release, *supra* note 157, at 29.

[236] Item 6 of Form ADV Part 2A. An adviser faces a variety of conflicts of interest that it is required to address in its Form ADV brochure, including that the adviser can potentially receive greater fees from its accounts having a performance-based compensation structure than from those accounts it charges a fee unrelated to performance (*e.g.,* an asset-based fee). *See* Brochure Adopting Release, *supra* note 157, at n.64 and accompanying text; 2008 Brochure Proposing Release, *supra* note 157, at n.51 and accompanying text.

[237] Items 11.C. and 11.D. of Form ADV Part 2A. For example, because of the information they have, advisers and broker-dealers and their personnel are in a position to abuse clients' positions by, for example, placing their own trades before or after client trades are executed in order to benefit from any price movements due to the clients' trades. An investment adviser is required to address this conflict in its Form ADV brochure. *See* Brochure Adopting Release, *supra* note 157, at n.83 and accompanying text.

[238] Item 12 of Form ADV Part 2A. Use of client commissions to pay for research and brokerage services presents money managers with significant conflicts of interest, and may give incentives for managers to disregard their best execution obligations when directing orders to obtain client commission services as well as to trade client securities inappropriately in order to earn credits for client commission services. *See* Brochure Adopting Release, *supra* note 157, at n.128 (citing Release 54165, *supra* note 187).

[239] Item 17 of Form ADV Part 2A. Each adviser must describe how the adviser addresses conflicts

may have several conflicts of interest with its retail investors that we are not proposing to include in the relationship summary. These include, for example, a broker-dealer's incentive to favor its institutional customers over its retail customers when making available proprietary research or certain investment opportunities, such as widely anticipated initial public offerings, acting as a market maker for a recommended security, using certain service providers, or voting client securities.[240] In addition, broker-dealers are subject to Exchange Act rules that require them to disclose in writing to the customer if they have any control, affiliation, or interest in a security they are offering or the issuer of such security.[241]

It is important for firms to disclose information about each of these conflicts to retail investors; however, we believe that requiring an exhaustive discussion of all conflicts in the relationship summary would make the relationship summary too long for its intended purpose—that is, focusing on key aspects of a firm and its services, as well as helping retail investors to make an informed choice between receiving the services of a broker-dealer or an investment adviser or among different broker-dealers or investment advisers. Since investment advisers already report conflicts of interest in Form ADV Part 2, a more exhaustive discussion of conflicts by investment advisers would be duplicative of certain disclosures provided in Form ADV Part 2, which is provided to clients of investment advisers, including retail investors.[242] While we are not proposing to require such detailed disclosures for broker-dealers in the relationship summary, Regulation Best Interest would require broker-dealers to disclose, in writing, all material conflicts of interest that are associated with a recommendation to a retail customer.[243]

We are proposing to require specific information about conflicts of interest related to financial incentives for recommending or selling proprietary products or products offered by third parties, and from revenue sharing arrangements. Such incentives could include, for example, the firm earning more money or the financial professional receiving compensation or other benefits, including an increase in compensation such as a bonus, when a retail investor invests in the product. Disclosure of these conflicts would highlight for retail investors that firms and financial professionals have financial incentives to place their own interests first when making investment recommendations. Including these disclosures prominently, in one place, at or before the start of a retail investor's relationship with a firm or financial professional would facilitate retail investors' understanding of the incentives that may be present throughout the course of the relationship. Retail investors also have indicated they find information about the sources and amount of compensation from third parties useful and relevant to making informed financial decisions before engaging a firm.[244] In addition, a number of commenters responding to Chairman Clayton's Request for Comment suggested disclosure that would focus on incentives associated with the products and services offered and how associated persons are compensated.[245]

We are also proposing to require disclosures about conflicts relating to principal transactions. Commenters recognized the importance of principal trading, with appropriate safeguards, including disclosure.[246] As we explain further below, we believe that investors should be aware of and understand this conflict at or before the start of the relationship.

Specifically, we are proposing that firms use the heading ''Conflicts of Interest'' under which a broker-dealer, investment adviser or dual registrant would describe three categories of conflicts, as applicable to the firm.[247] To emphasize the importance of conflicts, broker-dealers would be required to state the following language after the heading: ''We benefit from our recommendations to you.'' [248] Similarly, investment advisers would be required to state: ''We benefit from the advisory services we provide you.'' [249] Dual registrants would be required to state: ''We benefit from the services we provide you.'' [250] If all or a portion of a conflict is not applicable to the firm's business, the firm should omit that conflict or portion thereof.[251] If a conflict only applies to a dual registrant's brokerage accounts or investment advisory accounts, the firm would include that conflict in the applicable column.[252]

First, we propose that a firm be required to state, as applicable, that it has a financial incentive to offer or

of interest when it votes securities pursuant to its proxy voting authority, as applicable. *See* Brochure Adopting Release, *supra* note 157, at n.172 and accompanying text.

[240] *See* 913 Study, *supra* note 3, at nn.251 and 254 and accompanying text (discussing that courts have found that broker-dealers should have disclosed these conflicts).

[241] *See* Exchange Act rules 15c1–1, 15c1–5, and 15c1–6. Similarly, rule 15c1–6 requires written disclosure of the broker-dealer's interest in a security it is offering at or before the completion of the transaction. Self-regulatory organizations require similar disclosures. *See, e.g.,* FINRA Rules 2262 and 2269; and MSRB Rule G–22.

[242] For investment advisers, the Form ADV Part 2 brochure and the brochure supplement address many of the conflicts an adviser *may* have. Items in Part 2 of Form ADV may not address all conflicts an adviser may have, and may not identify all material disclosure that an adviser may be required to provide clients. As a result, delivering a brochure prepared under Form ADV's requirements may not fully satisfy an adviser's disclosure obligations under the Advisers Act. *See* Brochure Adopting Release, *supra* note 157, at n.7. Broker-dealers also must make a variety of disclosures, but the extent, form and timing of the disclosures are different. *See* 913 Study, *supra* note 3, at 55—58. In accordance with the Instructions to Form CRS, if a relationship summary is posted on a firm's website or otherwise provided electronically, the firm must use hyperlinks for any document that is cross-referenced in the relationship summary if the document is available online. *See* proposed General Instruction 1.(g) to Form CRS.

[243] *See supra* notes 229– 230 and accompanying text. When recommending a security, broker-dealers generally are liable under the antifraud provisions if they do not give ''honest and complete information'' or disclose any material adverse facts or material conflicts of interest, including any economic self-interest. *See, e.g., De Kwiatkowski* v. *Bear, Stearns & Co.,* 306 F.3d 1293, 1302 (2d Cir. 2002); *Chasins* v. *Smith, Barney & Co.,* 438 F.2d 1167, 1172 (2d Cir. 1970); In the Matter of Richmark Capital Corp., Exchange Act Release No. 48758 (Nov. 7, 2003) (Commission opinion) (''Release 48758'') (''When a securities dealer recommends stock to a customer, it is not only obligated to avoid affirmative misstatements, but also must disclose material adverse facts of which it is aware. That includes disclosure of ''adverse interests'' such as ''economic self interest'' that could have influenced its recommendation.'') (citations omitted).

[244] *See* 917 Financial Literacy Study, *supra* note 20, at xxi. (''The most useful and relevant information that the online survey respondents indicated that they favored to make informed financial decisions before engaging a financial intermediary includes information about . . . [s]ources and amount of compensation that a financial intermediary may receive from third parties in connection with and [*sic*] investment transaction . . .'').

[245] *See, e.g.,* SIFMA 2017 Letter; UBS 2017 Letter; ICI 2017 Letter; State Farm 2017 Letter; IAA 2017 Letter; Bernardi Securities 2017 Letter; Fidelity 2017 Letter.

[246] *See, e.g.,* SIFMA 2017 Letter (recommending that a best interest standard of conduct for broker-dealers would not prohibit principal trading, provided that such transactions be accompanied by written disclosure and corresponding client consent); Wells Fargo 2017 Letter. *See also* ICI 2017 Letter (recommending that a broker-dealer would be able to engage in principal trading, subject to appropriate limitations, disclosure, and customer consent); Bernardi Securities 2017 Letter (recommending that any revised standard of conduct for broker-dealers permit principal transactions, and suggesting that firms could implement disclosures and policies and procedures to protect investors from the related potential conflicts).

[247] Proposed Items 6.A. and 6.B. of Form CRS.

[248] Proposed Item 6.A. of Form CRS..

[249] *Id.*

[250] *Id.*

[251] Proposed Item 6.B. of Form CRS.

[252] *Id.*

recommend to the retail investor certain investments because: (a) They are issued, sponsored or managed by the firm or the firm's affiliates, (b) third parties compensate the firm when it recommends or sells the investments, or (c) both.[253] The firm also would provide examples of such types of investments, and state if its financial professionals receive additional compensation if the retail investor buys these investments.[254]

This conflict disclosure would highlight that a variety of financial incentives affects the incentives of the firm or its financial professional to offer or recommend certain investments to the retail investor.[255] These financial incentives can range from cash and non-cash compensation that a firm or financial professional receives for selling those investments as well as less direct financial incentives. In particular, investors might not be aware that the firm or its affiliate offers proprietary products that provide a financial incentive to the firm to recommend those products, that a third party provides incentives for a firm to recommend investments, or that the firm's financial professional will receive additional compensation if the retail investor buys certain investments. We believe that requiring this disclosure is consistent with indications that retail investors find information about sources and amount of compensation that firms receive from third parties useful to make informed financial decisions.[256] Additionally, we believe that it is important for firms to separately and explicitly disclose if the financial professionals benefit from these payments because these individuals are making the recommendations to the retail investors and their compensation is an incentive that could affect their advice.

We are also proposing to require examples of the types of investments associated with each of these conflicts (*e.g.,* mutual funds and variable annuities) because we believe it would be helpful for investors to be aware of the types of products for which firms and financial professionals have these incentives.[257] We considered whether to require a complete list of investments; however, we believe that a long list of the names of each of the affected products would not necessarily benefit investors or be helpful to them in their review of the firm's conflicts and could detract from the other information in the relationship summary.

Next, we propose that firms disclose revenue sharing arrangements by stating that the firm has an incentive to offer or recommend the retail investor to invest in certain investments because the manager or sponsor of those investments or another third party (such as an intermediary) shares with the firm revenue it earns on those investments.[258] The firm also would provide examples of such types of investments.[259] This disclosure would highlight another type of compensation firms receive that affects their incentives to offer or recommend certain investments to the retail investor, and like the disclosures regarding proprietary products and third party payments, would provide retail investors with information about sources of compensation the firm receives from third parties.[260] This requirement is intended to capture arrangements pursuant to which a firm receives payments or other benefits from third parties for recommending certain investments, including, for example, conflicts related to payment for distribution support or ongoing services from distributors or advisers of mutual funds, annuity products or other products. We are proposing that firms would be required to describe these and other conflicts of interest even if the compensation the firm receives is not shared with the firm's financial professionals, as the compensation can create incentives for the firm to promote certain investments over others. These types of distribution-related arrangements may give broker-dealers heightened incentives to market the shares of particular mutual funds, or particular classes of fund shares. Those incentives may be reflected in a broker-dealer's use of ''preferred lists'' that explicitly favor the distribution of certain funds, or they may be reflected in other ways, including incentives or instructions that the broker-dealer provides to its managers or its salespersons.[261]

Finally, we propose that firms address principal trading by stating that the firm can buy investments from a retail investor, and sell investments to a retail investor, from its account (called ''acting as principal'').[262] Firms must state that they can earn a profit on those trades, and disclose that the firm has an incentive to encourage the retail investor to trade with it.[263] If this activity is part of the firm's investment advisory business, it must state that the retail investor's specific approval is required on each transaction.[264]

While access to securities that are traded on a principal basis, such as certain types of municipal bonds, is important to many investors, principal trades by broker-dealers and investment advisers raise potential conflicts of

[253] Proposed Item 6.B.1. of Form CRS. We are not prescribing the specific language that firms must use to discuss each of these conflicts, which would give firms some flexibility to structure their disclosure, particularly if they offer proprietary products and receive compensation from third parties.

[254] Proposed Items 6.B.1. of Form CRS.

[255] The Commission has brought enforcement actions against firms that the Commission alleged to have failed to disclose fees, such as referral fees, that financial professionals receive as a result of recommending certain investments to retail investors. *See, e.g.,* In the Matter of Financial Design Associates, Inc. and Albert Coles Jr., Investment Advisers Act Release No. 2654 (Sept. 25, 2007) (settled action) (respondents failed to disclose to investment advisory clients payments received from a company in which clients were advised to invest); In the Matter of Energy Equities, Inc. and David G. Snow, Investment Advisers Act Release No. 1811 (Aug. 2, 1999) (settled action) (respondents received finder's fees or other compensation from issuers, the securities of which were recommended to clients or prospective clients); *Vernazza* v. *SEC,* 327 F.3d 851 (9th Cir. 2003).

[256] *See* 917 Financial Literacy Study, *supra* note 20, at xxi. The Commission's enforcement actions also have underscored how these types of compensation and benefits from third parties for recommending certain investments may produce conflicts of interest that lead firms and their financial professionals to favor those investments over others. *See, e.g.,* In the Matter of the Robare Group, LTD., Investment Advisers Act Release No. 3907 (Sep. 2, 2014) (Commission opinion) (investment adviser failed to disclose compensation it received through agreements with a registered broker-dealer and conflicts arising from that compensation).

[257] *See* proposed Items 6.B.1. of Form CRS.

[258] Proposed Item 6.B.2. of Form CRS.

[259] *Id.*

[260] The Commission has pursued enforcement actions against firms that the Commission alleged to have failed to disclose revenue sharing arrangements. *See, e.g.,* In re Edward D. Jones & Co, Securities Act Release No. 8520 (Dec. 22, 2004) (broker-dealer violated antifraud provisions of Securities Act and Exchange Act by failing to disclose conflicts of interest arising from receipt of revenue sharing, directed brokerage payments and other payments from ''preferred'' fund families that were exclusively promoted by broker-dealer); In re Morgan Stanley DW Inc., Securities Act Release No. 8339 (Nov. 17, 2003) (''Release 8339'') (broker-dealer violated antifraud provisions of Securities Act by failing to disclose special promotion of funds from fund families that paid revenue sharing and portfolio brokerage); In the Matter of KMS Financial Services, Inc., Investment Advisers Act Release No. 4730 (Jul. 19, 2017) (dually-registered investment adviser and broker-dealer that failed, in its capacity as an investment adviser, to disclose to its advisory clients compensation it received from a third party broker-dealer for certain investments it selected for its advisory clients); In the Matter of Voya Financial Advisors, Inc., Investment Advisers Act Release No. 4661 (Mar. 8, 2017) (registered investment adviser failed to disclose to its clients compensation it received through an arrangement with a third party broker-dealer and conflicts arising from that compensation).

[261] *See, e.g.,* Release 8339, *supra* note 260.

[262] Proposed Item 6.B.3. of Form CRS.

[263] *Id.*

[264] Section 206(3) of the Advisers Act. Proposed Item 6.B.3. of Form CRS.

interest.[265] Principal trading raises concerns because of the risks of price manipulation or the placing of unwanted securities into client accounts (*i.e.,* ''dumping'').[266] Under the Advisers Act, an adviser may not engage in a principal trade with an advisory client unless it discloses to the client in writing, before completion of the transaction, the capacity in which the adviser is acting, and obtains the consent of the client to the transaction.[267] Broker-dealers also are subject to a number of requirements when they engage in principal transactions with customers, including disclosure of such capacity on the trade confirmation.[268] There is no specific requirement for broker-dealers, however, to provide written disclosure prior to the trade or obtain consent for each principal transaction.[269] Our proposal to require firms to disclose, if applicable, that they engage in principal transactions, and to summarize the conflict of interest raised by principal transactions, would not replace the disclosure and consent requirements under the Advisers Act or any other requirement, such as under the Exchange Act. Rather, our disclosure requirement would supplement such disclosures by alerting retail investors to this practice and the related conflicts of interest at the start of the relationship.

We request comment generally on the conflicts of interest disclosures proposed to be included in the relationship summary, and in particular on the following issues:

• Do the proposed conflicts of interest disclosures encourage firms to provide information that is simple, clear, and useful to retail investors? Would the proposed disclosures help retail investors to compare the conflicts of interest associated with advisory services and brokerage services and the conflicts among firms? Does the relationship summary help retail investors understand that compensation to firms and financial professionals creates incentives that could impact the advice or recommendations that they provide? If not, should it do so and if so, what modifications should be made to the summary to address this concern?

• Should we require brief statements about particular conflicts of interest, as proposed, or should we require a more open-ended narrative or more prescribed wording? Would an open-ended narrative permit firms to tailor the disclosure and describe all of the conflicts they believe retail investors should know? Or would firms seek to provide so much information about their conflicts that the proposed page limit (or equivalent limit in electronic format) would not provide enough space for all of the disclosures? How would the required explanations of various items contribute to the readability and length of the relationship summary?

• Our intent in using layered disclosure for conflicts (*i.e.,* short summaries of certain types of conflicts of interest with information later in the relationship summary on where retail investors can find more information) is to highlight these conflicts and encourage retail investors to ask questions and seek more information about the firm's and its financial professionals' conflicts of interest. Do our proposed requirements achieve this goal? In light of our objective of keeping the relationship summary short, should we instead prescribe general language concerning the importance of understanding conflicts, while simply requiring cross-references to the relevant sections of Form ADV Part 2 brochure or brochure supplement (for investment advisers) and relevant disclosures typically included in account opening documents or websites (for broker-dealers)? Should we provide wording to encourage retail investors to ask questions about conflicts, including advising customers to go through all of the firm's and financial professional's conflicts with the financial professional? Are there other modifications or alternatives we should consider?

• Should we instead require firms to make the conflicts of interest disclosure more detailed, even if it results in a lengthier relationship summary?

• Are the proposed conflicts of interest disclosures too limited? Are there other types of conflicts we should include, such as additional disclosure currently required in the Form ADV Part 2 brochure or brochure supplement (for investment advisers), or disclosure typically included in account opening documents or websites (for broker-dealers)? Should we, for example, require firms to describe all of their conflicts and how they address them, such as specific information about incentives to favor certain clients over others, agency cross-trades, relationships with certain clients, personal trading by personnel, soft dollar practices, directed brokerage, proxy voting practices, or acting as a market maker for a recommended security? Or should we require firms to list all of their conflicts and provide cross references to where additional information about each conflict can be found (i.e., cross referencing the relevant sections of Form ADV Part 2 and analogous broker-dealer disclosures)? Would this detract from the brevity of the disclosure? Is there another way to provide additional information about conflicts to retail investors in a way that would be meaningful to them and would facilitate their ability to obtain additional information?

• Are there certain types of investments that should be disclosed by firms as ones that the firm ''issues, sponsors, or manages?'' For example, should we require firms to disclose that any investment with a firm's name in the title is generally an investment that the firm issues, sponsors, or manages? If a firm uses a name other than its own name to market proprietary investments, should we require firms disclose such other names?

• Should we require firms to disclose whether they provide ancillary services to retail investors themselves or through their affiliates so that retail investors better understand that the firm has incentives to select its affiliates over third parties?

• With respect to the required disclosure regarding financial incentives a firm has to offer or recommend investment in certain investments because they are offered by the firm's affiliates, or third parties compensate the firm for selling their investments, or both, would firms understand what types of financial incentives would be covered by this item—and what would not be covered? Should the Commission provide additional guidance or instructions to clarify?

• Should we require firms to disclose that they use third-party service providers that offer the firms or their financial professionals additional compensation? For example, some investment advisers select broker-

[265] *See* 913 Study, *supra* note 3, at 120.

[266] *See id.,* at 118.

[267] Section 206(3) of the Advisers Act. *See also* Opinion of Director of Trading and Exchange Division interpreting the reference to ''the transaction'' to require separate disclosure and consent for each transaction. Investment Advisers Act Release No. 40 (Feb. 5, 1945) (''[T]he requirements of written disclosure and of consent contained in this clause must be satisfied before the completion of each separate transaction. A blanket disclosure and consent in a general agreement between investment adviser and client would not suffice.''); 913 Study, *supra* note 3, at n.534 and accompanying text. An investment adviser must provide written disclosure to a client and obtain the client's consent at or prior to the completion of each transaction. 913 Study, *supra* note 3, at n.535 and accompanying text. *See also, e.g.,* Release 3929, *supra* note 133; In the Matter of JSK Associates, *et al.,* Investment Advisers Act Release No. 3175 (Mar. 14, 2011) (settled action).

[268] As an example of one such requirement, broker-dealers must disclose their capacity in the transactions (typically on the confirmation statement). *See* Exchange Act rule 10b–10.

[269] *See* 913 Study, *supra* note 3, at n.540 and accompanying text.

dealers to execute their clients' transactions that provide the adviser or financial professionals with compensation or other benefits, including in the form of client referrals. Should we highlight that compensation can be in the form of advisory client referrals?

• Firms would be required to provide examples of investments that firms have a financial incentive to offer. Are these requirements clear? Should we provide additional guidance? Should firms also be required to identify specific account types for which financial professionals receive incentives? Or should firms list all of their services or products that create the stated conflicts (or cross-reference to such disclosure elsewhere)? Should additional information be provided in this section of the relationship summary or should it be provided in an attachment?

• Should firms explicitly state that other firms offer similar products that could be less expensive for the retail investor? Should we require firms to disclose if the firm engages in principal trading, as proposed, including that the firm can earn a profit on these trades and may have an incentive to encourage the retail investor to trade with the firm? Should we require investment advisers to state the retail investor's specific approval on each principal transaction is required? Are there additional disclosures that we should require for broker-dealers?

• Should we require firms to disclose any additional conflicts of interest related to the compensation of financial professionals? For example, should firms be required to include any specific conflicts related to financial professionals' outside business activities? Should we require firms to include additional disclosure on compensation that a financial professional receives from third parties, such as compensation that an investment adviser representative receives in his or her capacity as a registered representative of an unrelated broker-dealer?

• Should we allow firms to choose the order they present the conflicts? For example, should firms be permitted to base the order on the conflicts they believe are most relevant in their business, or is a standardized order preferable to increase the comparability of the disclosures among different firms? If a firm does not engage in any practices that would be required to be disclosed, should we permit or require a firm to state that it does not have that conflict, or should we require firms to say nothing, as proposed? Would it be confusing to investors if, as proposed, the order was prescribed but some firms omit certain conflicts because they do not have the particular conflict? Would such presentation lessen the ability to compare conflicts across firms?

• Is the proposed format useful for retail investors in understanding and comparing conflicts of interest among firms? Would the use of tables, charts, graphs or other graphics or text features be helpful in explaining all or any particular conflict? If so, how could firms structure that disclosure?

• Should any of the conflicts be required to appear in the relationship summary, but outside of the conflicts of interest section?

7. Additional Information

We are proposing to require that firms include information on where retail investors can find more information about the firm's disciplinary events, services, fees, and conflicts, which facilitates the layered disclosure that the relationship summary provides.[270] This section would be titled ''Additional Information'' and firms would include the following after the title: ''We encourage you to seek out additional information.'' First, firms would be required to state whether or not they or their financial professionals currently disclose or are currently required to disclose certain legal or disciplinary events to the Commission, self-regulatory organizations, state securities regulators or other jurisdictions, as applicable. We are including information about a firm's and its financial professionals' disciplinary information because this information may assist retail investors in evaluating the integrity of a firm and its financial professionals.[271] For example, a prior disciplinary event could reflect upon the firm's integrity, affect the degree of trust and confidence a client would place in the firm, or impose limitations on the firm's activities.[272] Knowledge of a firm's and financial professional's disciplinary history is among the most important items for retail investors when deciding whether to receive financial services from a particular firm, according to one study.[273] Approximately 67.5% of the online survey respondents considered information about an adviser's disciplinary history to be absolutely essential, and about 20.0% deemed it important, but not essential.[274] But despite its importance, many investors do not review this information prior to engaging a firm.[275] A study also found that many retail investors would check the Investment Adviser Public Disclosure site (''IAPD'') for comparative information on investment advisers, including disciplinary history, if they were made aware of its existence.[276] We believe that requiring firms to state the existence of

[270] *See supra* notes 37, 48–50 and 139–141 and accompanying text (regarding the use of layered disclosure and alternative approaches to presentation).

[271] *See* Brochure Adopting Release, *supra* note 157, at n.81 and accompanying text. *See also* Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV, Investment Advisers Act Release No. 1862 (Apr. 5, 2000) [65 FR 20524 (Apr. 17, 2000)], at nn.148–149 and accompanying text (''2000 Brochure Proposing Release'') (''When assessing whether an adviser will fulfill its obligations to clients, an investor would likely give great weight to whether the adviser has met its fiduciary and other legal obligations in the past.''); Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Amend FINRA Rule 8312 (FINRA BrokerCheck Disclosure) to Expand the Categories of Civil Judicial Disclosures Permanently Included in BrokerCheck, Release No. 34–71196 (Dec. 27, 2013) [79 FR 417 (Jan. 3, 2014)] (''By making certain of this information publicly available, BrokerCheck, among other things, helps investors make informed choices about the individuals and firms with which they conduct business.'').

[272] *See* Brochure Adopting Release, *supra* note 157, at n.85.

[273] *See* 917 Financial Literacy Study, *supra* note 20, at nn.308 and 498 and accompanying text (''When asked how important certain factors would be to them if they were to search for comparative information on investment advisers, the majority of online survey respondents identified the fees charged and the adviser's disciplinary history as the most important factors.'').

[274] *Id.*

[275] 917 Financial Literacy Study, *supra* note 20, at n.770 (citing Applied Research Consulting LLC for FINRA Investor Education Foundation, *Financial Capability in the United States: Initial Report of Research Findings from the 2009 National Survey* (Dec. 1, 2009), *available at http://www.usfinancialcapability.org/downloads/NFCS_2009_Natl_Full_Report.pdf* (''2009 National Survey Initial Report''), which revealed that only 15% of respondents claimed that they had checked a financial professional's background or credentials with a state or federal regulator, although the Commission notes that the study encompasses a wide group of advisors, such as debt counselors and tax professionals.). In addition, the FINRA 2015 Investor Survey found that only 24% of investors were aware of Investor.gov; only 16% were aware of BrokerCheck; only 14% were aware of the IAPD website, and only 7% had used BrokerCheck. FINRA, *Investors in the United States 2016* (Dec. 2016), *available at http://www.usfinancialcapability.org/downloads/NFCS_2015_Inv_Survey_Full_Report.pdf*).

[276] *See* 917 Financial Literacy Study, *supra* note 20, at nn.317–319 and accompanying text ([A]bout 76.5% of the online survey respondents reported that, in selecting their current adviser, they did not use an SEC-sponsored website to find information about the adviser. 73% of respondents stated that they would check IAPD if they were made aware of its existence. Of that subset—those who reported not using an SEC-sponsored website—approximately 85.2% indicated that they did not know that such a website was available for that purpose. Of that majority (*i.e.,* a further subset)—those who were unaware of such a website—approximately 73.5% reported that they would review information about their adviser on an SEC-sponsored website if they knew it were available).

disciplinary events, provide specific questions for retail investors to ask, and provide information on where retail investors can find more information, would cause more retail investors to seek out this information and would make them better informed when they choose a firm and a financial professional.[277]

Specifically, in the relationship summary, firms would state ''We have legal and disciplinary events'' if they are required to disclose (i) disciplinary information per Item 11 of Part 1A or Item 9 of Part 2A of Form ADV,[278] or (ii) legal or disciplinary events per Items 11A–K of Form BD (''Uniform Application for Broker-Dealer Registration'') [279] except to the extent such information is not released through BrokerCheck pursuant to FINRA Rule 8312 or in IAPD.[280] Regarding their financial professionals, firms would determine whether they need to include the statement based on legal and disciplinary information on Form U4,[281] Form U5 [282] and Form U6.[283] In particular, firms would be required to state, ''We have legal and disciplinary events'' if they have financial professionals for whom disciplinary events are reported per Items 14 A–M on Form U4, Items 7(a) and 7(c)–(f) on Form U5,[284] and Form U6 except to the extent such information is not released through BrokerCheck pursuant to FINRA Rule 8312 or in IAPD.[285]

We considered requiring firms to provide additional details about the reported legal and disciplinary events of the firms and their financial professionals. For example, we could have proposed to require firms to include details about the type and number of the reported events. Broker-dealers and investment advisers do not report all of the same types of disciplinary events. We also considered whether to require firms to only discuss the types of disciplinary events that both broker-dealers and investment advisers report, require investment advisers to disclose complaints and other disciplinary events that only broker-dealers report, or create separate requirements to require firms to disclose certain types of events in the relationship summary without reference to information in other disclosures.

We are not proposing to take any of these approaches because this is summary disclosure rather than a comprehensive discussion of a firm's legal and disciplinary history. We believe that for many firms, requiring additional information would include too much detail for short summary disclosure, and updating these details in the relationship summary on an ongoing basis would add significant costs without compensating benefit. The information already is required to be disclosed elsewhere, and the relationship summary as proposed would direct retail investors to those resources. We believe that requiring an affirmative statement that the firm and its financial professionals have reportable legal or disciplinary events, if applicable, will flag this important issue for retail investors and help them to determine whether they want additional information in other disclosures. By proposing to base the new disclosure on information that is already reported elsewhere and also to include details about where to find more information, we would give retail investors the tools to learn more.[286] Furthermore, as discussed below, the statement encouraging retail investors to visit Investor.gov for more information would help retail investors to more easily learn additional details from the firms themselves and from their existing disclosures.[287]

Next, all firms would be required to include the following wording to highlight where retail investors can find more information about the disciplinary history of the firm and its financial professionals, whether or not the firm is required to state the existence of legal or disciplinary events in the relationship summary: ''Visit Investor.gov for a free and simple search tool to research our

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[277] In addition, this would address an issue that was highlighted by the Commission's Investor Advisory Committee, which, among other things, encouraged the Commission to develop an enhanced approach to the disclosure of disciplinary events. Broker-Dealer Fiduciary Duty Recommendations, *supra* note 10 (recommending a summary disclosure document that includes, among other disclosures, basic information about a firm's disciplinary record).

[278] Proposed Item 7.B. of Form CRS. Generally, investment advisers are required to disclose on Form ADV Part 2A any legal or disciplinary event, including pending or resolved criminal, civil and regulatory actions, if it occurred in the previous 10 years, that is material to a client's (or prospective client's) evaluation of the integrity of the adviser or its management personnel, and include events of the firm and its personnel. *See* Brochure Adopting Release, *supra* note 157, at 22–27. Items 9.A., 9.B., and 9.C. provide a list of disciplinary events that are presumptively material if they occurred in the previous 10 years. However, Item 9 requires that disciplinary events more than 10 years old be disclosed if the event is so serious that it remains material to a client's or prospective client's evaluation of the adviser and the integrity of its management.

[279] Item 11 of Form BD requires disclosure on the relevant Disclosure Reporting Page (''DRP'') with respect to: (A) felony convictions, guilty pleas, ''no contest'' pleas or charges in the past ten years; (B) investment-related misdemeanor convictions, guilty pleas, ''no contest'' pleas or charges in the past ten years; (C) certain SEC or the Commodity Futures Trading Commission (CFTC) findings, orders or other regulatory actions (D) other federal regulatory agency, state regulatory agency, or foreign financial regulatory authority findings, orders or other regulatory actions; (E) self-regulatory organization or commodity exchange findings or disciplinary actions; (F) revocation or suspension of certain authorizations; (G) current regulatory proceedings that could result in ''yes'' answers to items (C), (D) and (E) above; (H) domestic or foreign court investment-related injunctions, findings, settlements or related civil proceedings; (I) bankruptcy petitions or SIPC trustee appointment; (J) denial, pay out or revocation of a bond; and (K) unsatisfied judgments or liens. Some of these disclosures are only required if the relevant action occurred within the past ten years, while others must be disclosed if they occurred at any time.

[280] FINRA Rule 8312 governs the information FINRA releases to the public via BrokerCheck. FINRA established BrokerCheck in 1988 (then known as the Public Disclosure Program) to provide the public with information on the professional background, business practices, and conduct of FINRA member firms and their associated natural persons. The information that FINRA releases to the public through BrokerCheck is derived from the CRD system, the securities industry online registration and licensing database. Firms, their associated natural persons and regulators report information to the CRD system via the uniform registration forms (Form U4 (Uniform Application for Securities Industry Registration or Transfer), Form U5 (Uniform Termination Notice for Securities Industry Registration), Form U6 (Uniform Disciplinary Action Reporting Form), Form BD (Uniform Application for Broker-Dealer Registration), Form BDW (Uniform Request for Broker-Dealer Withdrawal), and Form BR (''Uniform Branch Office Registration Form'')). Under FINRA Rule 8312, FINRA limits the information that is released to BrokerCheck in certain respects. For example, pursuant to FINRA Rule 8312(d)(2), FINRA shall not release ''information reported on Registration Forms relating to regulatory investigations or proceedings if the reported regulatory investigation or proceeding was vacated or withdrawn by the instituting authority.'' We believe it is appropriate to limit disclosure in the relationship summary to disciplinary information or history that would be released to BrokerCheck.

[281] Form U4 (Uniform Application for Securities Industry Registration or Transfer) requires disclosure of registered representatives' criminal, regulatory, and civil actions similar to those reported on Form BD as well as certain customer-initiated complaints, arbitration, and civil litigation cases. *See generally* Form U4.

[282] Form U5 (Uniform Termination Notice for Securities Industry Registration) requires information about representatives' termination from their employers. *See* Form U5.

[283] Form U6 (Uniform Disciplinary Action Reporting Form) is used by SROs, regulators, and jurisdictions to report disciplinary actions against broker-dealers and associated persons. This form is also used by FINRA to report final arbitration awards against broker-dealers and associated persons. *See* Form U6.

[284] The disclosure would be triggered by reportable information on Items 7(a) and 7(c) through (f). Item 7(b) (Internal Review Disclosure) is not released to BrokerCheck by FINRA, pursuant to FINRA Rule 8312(d)(3). As noted above (*see supra* note 280), we believe it is appropriate to limit disclosure in the relationship summary to disciplinary information or history that would be released to BrokerCheck.

[285] Proposed Item 7.B.3. of Form CRS.

[286] Proposed Item 7.D. of Form CRS.

[287] *Id.*

firm and our financial professionals.'' [288]

Retail investors would further benefit from understanding how to report problems and complaints to the firm and regulators. Accordingly, we propose to require that firms include the following wording next in this section:

''To report a problem to the SEC, visit Investor.gov or call the SEC's toll-free investor assistance line at (800) 732–0330. [To report a problem to FINRA, [ ].] If you have a problem with your investments, account or financial professional, contact us in writing at [insert your primary business address].[289]

Broker-dealers and dual registrants also would include the bracketed language regarding how to report a problem to FINRA. Firms would be required to review and update (if needed) the current telephone numbers for the SEC and FINRA at least annually.[290]

Firms would be required to state where the retail investor can find additional information about their brokerage and investment advisory services, as applicable. Broker-dealers would be required to direct retail investors to additional information about their brokers and services on BrokerCheck (*https://brokercheck.finra.org*), their firm websites (including a link to the portion of the website that provides up-to-date information for retail investors), and the retail investor's account agreement.[291] Broker-dealers that do not have public websites would be required to state where retail investors can find up-to-date information.[292]

Investment advisers likewise would be required to direct retail investors to additional information in the firm's Form ADV Part 2 brochure and any brochure supplement provided by a financial professional to the retail investor.[293] If an adviser has a public website and maintains a current version of its firm brochure on the website, the firm would be required to provide the website address.[294] If an adviser does not have a public website or does not maintain its current brochure on its public website, then the adviser would provide the IAPD website address (*https://adviserinfo.sec.gov*).[295]

Unlike investment advisers, which deliver brochures and brochure supplements to clients, broker-dealers are not currently required to deliver to their retail investors written disclosures covering their services, fees, conflicts, and disciplinary history in one place.[296] However, under Regulation Best Interest, broker-dealers would be required to disclose, in writing, the material facts relating to the scope and terms of the relationship with the retail customer including all material conflicts of interest that are associated with the recommendation.[297] We understand that, under current practice, broker-dealers typically provide information about some or all of the categories of disclosure included in this relationship summary on their firm websites and in their account opening agreements. We recognize that the different disclosure requirements for investment advisers and broker-dealers may result in retail investors having access to more information about investment advisers on a particular topic as compared to information about broker-dealers and *vice versa*. We request comment on whether we should take additional steps to ensure that retail investors have access to a similar amount of additional information about each of the topics covered by the relationship summary, such as by requiring firms to include appendices or hyperlinks with specific information.

We request comment generally on the disclosure about where to find additional information, and in particular on the following issues:

- Do commenters agree that it is important for retail investors to know of a firm and its financial professionals' legal and disciplinary events before entering into an agreement with a firm? Why or why not?
- Is including the disciplinary history disclosure in the additional information section sufficient to draw a retail investors' attention or encourage retail investors to ask follow-up questions on this topic?
- Would the proposed format with prescribed wording effectively communicate information about disciplinary events to retail investors? Or should we use a table with yes/no check boxes or another graphical format to describe this information, or should we permit a firm to state in its own words whether it has reported any events? What approach would permit easier comparison by retail investors across firms, including dual registrants?
- Would more detail about these events be more beneficial and easily understandable for retail investors? For example, should firms be required to provide background about the types of events that would trigger the disclosure (such as criminal, civil, and regulatory actions and, for broker-dealers and financial professionals, customer complaints, arbitrations and bankruptcies)? Should we require separate disclosures for firms and their financial professionals? Should we consider requiring a more specific list of the types of disciplinary events that firms and financial professionals report and require firms to state whether there are reported disclosures for each type? For example, should firms be required to state they have reported disclosures for criminal actions, civil actions and administrative proceedings, and for broker-dealers specifically, arbitrations and complaints? Should we instead require firms to disclose the total number of the legal and disciplinary events that are reported on Form BD, Form ADV, and/or Forms U4, U5, and U6, as applicable? Or should we require firms to report the total number of all reported criminal actions, civil actions, administrative proceedings, arbitrations, and complaints for them and their financial professionals, as applicable? Would this information be confusing for retail investors without more information about each reported event? If we do require this information, should we require firms to disclose the percentage of a firm's total financial professionals that have reported disciplinary events? As part of this approach, should we require a firm to disclose its total number of financial professionals to provide additional context for the percentage?
- Should we require firms to include specific wording directing retail investors to ask them questions about these events and to review more detailed disclosures by searching Investor.gov?
- Should firms be required or permitted to state that they do not currently have reportable legal and/or disciplinary events, if that is the case? Should we require firms to distinguish whether they or their financial professionals have reportable

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288 Proposed Item 7.C. of Form CRS.

289 Proposed Item 7.D. of Form CRS.

290 *Id.*

291 Proposed Item 7.E.1. of Form CRS.

292 *Id.*

293 Proposed Item 7.E.2. of Form CRS.

294 *Id.*

295 *Id.* SEC- and state-registered investment advisers are required to file their brochures and brochure amendments through the IARD system. *See* rules 203–1 and 204–1 of the Advisers Act and similar state rules. Members of the public can view an adviser's most recent Form ADV online at the IAPD website: *www.adviserinfo.sec.gov*.

296 Broker-dealers are required under certain circumstances, such as when effecting certain types of transactions, to disclose certain conflicts of interest to their customers in writing, in some cases at or before the time of the completion of the transaction. *See, e.g., supra* notes 228 and 241 and accompanying text. *See also* 913 Study, *supra* note 3, at nn.256–259 and accompanying text; *supra* notes 230 and 243–243 and accompanying text (describing broker-dealer obligations under proposed Regulation Best Interest).

297 *See* Regulation Best Interest Proposal, *supra* note 24, at section II.D.1.

disciplinary events, for example by stating ''Our firm has legal and disciplinary events'' or ''We have financial professionals who have legal and disciplinary events''?

• Do commenters agree with requiring disclosure if firms or financial professionals have reported legal and/or disciplinary events on Form BD, Forms U4, U5 or U6, and Form ADV, as applicable? Do commenters agree with the specific items on those forms that we have identified as triggering reportable events? Should we only require disclosure of the types of legal events that both broker-dealers and investment advisers report? For example, should we require all firms to disclose financial information, which broker-dealers are required to report pursuant to Items 11 (I, J, and K) on Form BD but investment advisers do not report? Or, in the alternative, should we exclude financial disclosures from a broker-dealer's reportable legal or disciplinary events? Do commenters agree that the legal or disciplinary events triggering disclosure on the relationship summary should be the same for financial professionals working for broker-dealers as for investment advisers? If not, why not?

• Do commenters agree that, for broker-dealers and financial professionals of broker-dealers and investment advisers, we should exclude information that is not released to BrokerCheck or IAPD pursuant to FINRA Rule 8312? BrokerCheck and IAPD include additional information, including summary information about certain arbitration awards against a financial professional, or against a firm in BrokerCheck, involving a securities or commodities dispute with a public customer. Although broker-dealers are not required to report arbitrations on Form BD, should we include arbitrations as reportable events in light of the BrokerCheck disclosures? If so, how would commenters suggest articulating the required disclosure?

• Pursuant to FINRA Rule 4530, broker-dealers are required to disclose certain information to FINRA that is not reported on Form BD (*e.g.,* customer complaints and arbitrations). Should we include disclosures made to FINRA pursuant to FINRA Rule 4530 as reportable events? If so, should we require disclosure of similar events by investment advisers? Why or why not?

• Do commenters believe that stating whether a firm has legal and disciplinary events and then providing hyperlinks on where to find additional information is the correct approach? Should we explicitly require deep links? Why or why not? Do commenters believe that retail investors will check Investor.gov? Should we require firms to cross reference other sources of disciplinary information, including providing direct links to the IAPD or BrokerCheck? Why or why not?

• Rather than asking firms to identify whether they have legal and disciplinary events, should the relationship summary note that retail investors may want to consider this information and then encourage retail investors to ask their financial professional for more details and include cross references to where further information can be found? Why or why not? With respect to robo-advisers or broker-dealers providing online services, will a financial professional be available to answer these types of questions? [298]

• Should we adopt a definition of ''financial professional'' for purposes of this disclosure? If so, how would commenters suggest formulating the definition?

• Our intent in using layered disclosure, with short summaries of selected disclosures and information on where retail investors can find more information, is to encourage retail investors to ask questions and seek more information about the firm's and their financial professionals' services, fees, conflicts of interest and disciplinary events. Does the proposed relationship summary, in general, and this additional information section, in particular, achieve this goal? Are there modifications or alternatives we should consider to achieve this goal?

• In addition or as an alternative to the proposed cross references to an investment adviser's Form ADV brochure and brochure supplement(s) and account agreement, and to a broker-dealer's public website, account agreement and BrokerCheck, should the relationship summary direct retail investors to other sources of information? Should we require firms to include public website addresses and hyperlinks to the sources of additional information, if available? Do firms' websites typically include additional information about topics included in the relationship summary? Given that not all firms have a public website or maintain current information on a public website (*e.g.,* its current brochure or other current information), are there other places to which firms should direct retail investors to look for up-to-date information? Should we require firms that do not already maintain a public website to establish one for purposes of making the relationship summary publicly available?

8. Key Questions

We are proposing to require that firms include questions for retail investors to ask their financial professionals in the relationship summary. By requiring these questions, we intend to encourage retail investors to have conversations with their financial professionals about how the firm's services, fees, conflicts and disciplinary events affect them. We encourage financial professionals to engage in balanced and meaningful conversations with their retail investors to facilitate investors making informed decisions, using these key questions as a guide. Firms should use formatting to make the questions more noticeable and prominent (for example, by using a larger font, a text box, different font, or lines to offset the questions from the other sections).[299] Firms would be required to include ten questions, as applicable to their particular business, under the heading ''Key Questions to Ask'' after stating the following: ''Ask our financial professionals these key questions about our investment services and accounts.'' The required questions would be:

1. Given my financial situation, why should I choose an advisory account? Why should I choose a brokerage account?

2. Do the math for me. How much would I pay per year for an advisory account? How much for a typical brokerage account? What would make those fees more or less? What services will I receive for those fees?

3. What additional costs should I expect in connection with my account?

4. Tell me how you and your firm make money in connection with my account. Do you or your firm receive any payments from anyone besides me in connection with my investments?

5. What are the most common conflicts of interest in your advisory and brokerage accounts? Explain how you will address those conflicts when providing services to my account.

6. How will you choose investments to recommend for my account?

7. How often will you monitor my account's performance and offer investment advice?

8. Do you or your firm have a disciplinary history? For what type of conduct?

[298] Robo-advisers should also keep in mind the considerations set forth in the robo-adviser guidance update specifically as it relates to the substance and presentation of disclosures. *See* Robo-Advisers, IM Guidance Update No. 2017–02 (Feb. 23, 2017), *available at https://www.sec.gov/investment/im-guidance-2017-02.pdf.*

[299] Proposed Item 8 of Form CRS.

9. What is your relevant experience, including your licenses, education, and other qualifications? Please explain what the abbreviations in your licenses are and what they mean.

10. Who is the primary contact person for my account, and is he or she a representative of an investment adviser or a broker-dealer? What can you tell me about his or her legal obligations to me? If I have concerns about how this person is treating me, who can I talk to? [300]

We are proposing to allow firms to modify or omit portions of these questions, as applicable to their business.[301] We are also proposing to require a standalone broker-dealer and a standalone investment adviser, to modify the questions to reflect the type of account they offer to retail investors (*e.g.,* advisory or brokerage account).[302] In addition, we are proposing that firms could include any other frequently asked questions they receive following these questions. Firms would not, however, be permitted to exceed fourteen questions in total in order to limit the length of the relationship summary.[303]

We recognize that advisers providing computer-generated, automated advice, often referred to as ''robo-advisers,'' and online-only broker-dealers may employ business models that offer varying levels of interaction or no interaction with a financial professional. We are proposing to require advisers providing automated advice or broker-dealers providing online-only services without a particular individual with whom a retail investor can discuss these questions to include a section or page on their website that answers each of the above questions, and provide a hyperlink in the relationship summary to that section or page.[304] If the firm provides automated advice, but makes a financial professional available to discuss the existing account with a retail investor, that firm generally should also make the financial professional available to discuss these questions with the retail investor.

We believe that many of these questions would help retail investors to elicit more detail concerning the items discussed in the relationship summary. For example, the questions asking why an investor should choose an advisory or brokerage account and how much the investor can expect to pay are intended to help the retail investor receive information about services and fees that are tailored to that particular investor's circumstances. We believe that the financial professional generally would have access to the information needed to provide this information to a particular retail investor during the account opening process.[305] Questions about how the financial professional and the firm make money and about conflicts of interest would assist investors in understanding the extent to which compensation creates incentives for a financial professional to take his or her own interests into account in providing services. Similarly, the last question in the list of questions, which asks about a retail investor's primary contact at the firm and that financial professional's legal obligations, is intended to elicit a conversation about the different legal obligations of firms and financial professionals acting in an investment advisory capacity and in a brokerage capacity. Other items allow the investor to learn more specific information about the firms and financial professional, such as additional conflicts the firms or its financial professionals might have or disciplinary history.

The proposed questions cover all of the sections in the relationship summary. They also include one additional topic about the financial professional's relevant experience, including licenses and other qualifications. In our experience, the relevant experience, including licenses, education, and other qualifications for a particular financial professional are important to retail investors.[306] However, if we required firms to disclose the educational and professional certifications of each financial professional, firms would have to attach a separate disclosure for each particular financial professional (similar to the Form ADV brochure supplement or the information about financial professionals provided on BrokerCheck and IAPD) or would have to include lengthy disclosure with information about all of their financial professionals. We believe this would be more burdensome than prompting retail investors to ask their financial professionals these questions to encourage a conversation about these topics, if such a conversation is important to that investor. We understand that including ''Key Questions to Ask'' would result in some firms creating policies and procedures, including supervision and compliance reviews, relating to how their financial professionals respond to the questions.

We request comment generally on the questions proposed to be included in the relationship summary, and in particular on the following issues:

- Would our proposed questions encourage discussions between retail investors and their financial professionals? Would they help retail investors become informed about how a firm's services, fees, conflicts, and disciplinary events affect them? Would they help investors to compare investment advisers and broker-dealers?
- Would financial professionals be able to answer these ''Key Questions to Ask''? Do they have access to personalized information about the retail investor and the retail investor's account to be able to, for example, put together personalized fee information and estimates during the account opening process? To the extent responses would require information about the particular retail investor, would firms need to change the account opening process in order to obtain that information and provide responses?
- Should we require or permit firms to include these questions throughout the relationship summary rather than, or in addition to, including the questions in the ''Key Questions to Ask''? In our proposal, for example, the fees and costs section of the relationship summary directs retail investors to ask their financial professionals for personalized fee information. Are there other disclosures in the relationship summary for which we should require or permit firms to also include a question to ask as part of the disclosure? If so, which disclosures? Could firms use technology such as pop-ups or hovers, or internal links, to connect the relevant question(s) in the key questions to ask to the disclosure in the relationship summary?
- Would firms create policies and procedures, including supervision and compliance reviews, relating to how their financial professionals respond to these questions? Would implementing and maintaining such processes be burdensome or costly for firms? Why or why not? Do investment advisers and broker-dealers currently have systems in place to answer these questions, particularly the request to ''do the math for me'' and provide not only fee

[300] Proposed Item 8 of Form CRS.

[301] *Id.*

[302] *Id.*

[303] *Id.*

[304] *Id.*

[305] *See supra* Section II.B.4, ''Summary of Fees and Costs.''

[306] *See* 917 Financial Literacy Study, *supra* note 20, at 24 (''Some examples of information that commenters indicated should be included in a summary disclosure document for an investment product or service include descriptions of . . . any eligibility requirements.''); Brochure Adopting Release, *supra* note 157, at nn.213–216 and accompanying text (discussing commenters that supported the brochure supplement, which contains information about the educational background, business experience, and disciplinary history (if any) of the supervised persons who provide advisory services to the client).

information related to the relationship and certain externalized fees, but also information about fees that are implicit to a given product?

• Do firms anticipate that they would implement recordkeeping policies and procedures to address communications between financial professionals and retail investors about the ''Key Questions to Ask''? What kind of recordkeeping policies and procedures would firms anticipate implementing in order to address such communications? Should we require financial professionals to highlight these key questions when they deliver a relationship summary to a retail investor? How could the questions be highlighted when the relationship summary is delivered electronically?

• Should we require financial professionals to initiate a conversation about these key questions if the retail investor does not raise these questions?

• Should we, as proposed, permit firms to omit any of the proposed questions that are not applicable to their business, and permit firms to add additional questions for retail investors to ask about the disclosures in their relationship summaries? For example, should robo-advisers and online broker-dealers be allowed to omit the questions concerning the financial professional's relevant experience and whether the investor's primary contact is an investment adviser or broker-dealer? Should we add questions specific to investment advisers offering automated advice, such as how the robo-adviser's models are designed, including the underlying assumptions?

• Should we include any additional questions in our proposed list of questions, or remove any proposed questions? If so, what additional questions should we add, and which questions should we remove, and why? For example, instead of including a question about a financial professional's licenses and other qualifications in this section, should we instead require firms to discuss information about licensing and other qualifications in the relationship summary, including educational background, designations held, and examinations passed? Should we add a question comparing services offered with financial planning and wrap fee programs?

• Do commenters agree that including a question about a financial professional's licenses and other qualifications would provide useful information to retail investors, given the expansive list of professional designations? Should we instead permit or require financial professionals to include a list of certain licenses or other qualifications in a separate disclosure and, if so, which designations should be included?

• We are proposing to permit firms to include up to fourteen questions. Do commenters agree with this approach? Should we allow firms to include more or fewer questions?

• We are proposing to require that robo-advisers and online-only brokers include a section or page on their websites that answers each of these proposed questions, and include a hyperlink in the relationship summary to where the answers are posted. How will these advisers and broker-dealers be able to answer the fact specific questions in a generalized format on the website? Are there alternative ways in which such advisers or broker-dealers should be required to provide answers to these proposed questions? For example, should robo-advisers use a chat or other message function, or answer questions by email? Would this work for robo-advisers that offer recommendations to retail investors without providing them any way to reach a financial professional at the firm? Should we require all advisers to include the responses to these questions on their websites, including robo-advisers that make available financial professionals to answer retail investors' questions?

• Should we require the order of the questions to be fixed? Does the proposed order advance our goal? What changes, if any, should be made to the proposed order? Should there be sub-categories of questions?

C. Delivery, Updating, and Filing Requirements

Our proposal would require registered investment advisers, registered broker-dealers that serve retail customers and dual registrants to deliver a relationship summary.[307] Delivery of the relationship summary would not necessarily relieve the firm of any other disclosure obligations it has to its retail investors or prospective retail investors under any federal or state laws or regulations.

The relationship summary requirement would be in addition to, and not in lieu of, current disclosure and reporting requirements or other obligations for broker-dealers and investment advisers.[308] Broker-dealers are liable under the antifraud provisions of the federal securities laws for failure to disclose material information to their customers when they have a duty to make such disclosure.[309] When recommending a security, broker-dealers may be liable under the antifraud provisions if they do not give ''honest and complete information'' or disclose any material adverse facts or material conflicts of interest, including any economic self-interest.[310] Among other specific disclosure obligations, broker-dealers are required to disclose certain potential conflicts to their customers under certain circumstances, such as disclosing at or before the time of the completion of the transaction whether the broker-dealer is acting as agent or principal, and its compensation and any third-party remuneration it has received or will receive.[311] Broker-dealers typically provide information about their services, fees, and conflicts on their websites and in their account opening agreements. Disciplinary history on broker-dealers, details on the background, qualifications, and disciplinary history of financial professionals associated with broker-dealers, and customer complaints and arbitrations against them, are available on FINRA's BrokerCheck website.[312]

Investment advisers deliver to clients a ''brochure'' (and/or a ''wrap fee program brochure,'' as applicable) and ''brochure supplement'' required by Form ADV Part 2.[313] The brochure is a plain language, narrative document that addresses, among other things, an investment adviser's advisory business,

[307] *See* Advisers Act proposed rule 204–5 and Exchange Act proposed rule 17a–14.

[308] For example, the relationship summary would not necessarily satisfy the disclosure requirements under proposed Regulation Best Interest. Regulation Best Interest would require broker-dealers to disclose in writing, before or at the time of a recommendation, the material facts related to the scope and terms of the relationship with the retail customer, including all material conflicts of interest that are associated with the recommendation. Regulation Best Interest Proposal, *supra* note 24, at section II.D.1 (noting that the relationship summary would reflect initial layers of disclosure, and the disclosure obligation of proposed Regulation Best Interest would reflect more specific and additional, detailed layers of disclosure).

[309] *See Basic* v. *Levinson,* 485 U.S. 224, 239 n.17 (1988) (''Silence, absent a duty to disclose, is not misleading under Rule 10b–5.''); *Chiarella* v. *U.S.,* 445 U.S. 222, 228 (1980) (explaining that a failure to disclose material information is only fraudulent if there is a duty to make such disclosure arising out of ''a fiduciary or other similar relation of trust and confidence''); *SEC* v. *Monarch Funding Corp.,* 192 F.3d 295, 308 (2d Cir. 1999) (explaining that defendant is liable under section 10(b) and rule 10b–5 for material omissions ''as to which he had a duty to speak'').

[310] *See, e.g., De Kwiatkowski* v. *Bear, Stearns & Co.,* 306 F.3d at 1302; *Chasins* v. *Smith, Barney & Co.,* 438 F.2d at 1172.

[311] 17 CFR 240.10b–10(a)(2).

[312] *See https://brokercheck.finra.org.*

[313] *See* Advisers Act rule 204–3; Instructions 1 and 2 of Instructions for Part 2A of Form ADV; Instructions 2 and 3 of Instructions for Part 2B of Form ADV. An investment adviser that sponsors a wrap fee program is generally required to complete a wrap fee program brochure. *See* Appendix 1 to Form ADV Part 2A.

conflicts of interest with its clients, fees, and disciplinary history.[314] The brochure supplement contains information about the advisory personnel providing clients with investment advice.[315] The wrap fee program brochure provides prospective wrap fee program clients with important information regarding the cost of the programs and the services provided. The current Form ADV Parts 1 and 2A are filed by investment advisers, and details about the background qualifications, registrations and disciplinary history of financial professionals supervised by the investment adviser, are available on IAPD.[316]

The current disclosure requirements and obligations result in varying degrees and kinds of information to investors, but we believe that all retail investors would benefit from a short summary that focuses on certain key aspects of the firm and its services. By requiring both investment advisers and broker-dealers to deliver a relationship summary that discusses both types of services and their differences, the relationship summary would help all retail investors, whether they are considering an investment adviser or a broker-dealer. A relationship summary would help retail investors to understand key aspects of a particular firm, to compare different types of accounts, and to compare that firm with other firms. While the information required by the relationship summary is generally already provided in greater detail for investment advisers by Form ADV Part 2, the relationship summary would provide in one place, for the first time, summary information about the services, fees, conflicts, and disciplinary history for broker-dealers.

1. Filing Requirements

As proposed, firms would be required to file their relationship summary with the Commission, and the relationship summary will be available on the Commission's public disclosure website. The essential purpose of the relationship summary is to provide information to retail investors to help them decide whether to engage a particular firm or financial professional and open an investment advisory or brokerage account. If a firm does not have retail investor clients or customers and is not required to deliver a relationship summary to any clients or customers, the firm would not be required to prepare or file a relationship summary.[317] Broker-dealers would file their relationship summaries electronically in a text-searchable format with the Commission on EDGAR. Investment advisers would file their relationship summaries electronically in a text-searchable format through IARD in the same manner as they currently file Form ADV Parts 1A and 2A. Dual registrants would file on both EDGAR and IARD. All previously filed versions of relationship summaries filed via EDGAR will remain available to the public. Although previously filed versions of an adviser's relationship summary would remain stored as Commission records in IARD, only the most recent version of an adviser's relationship summary will be available through the Commission's public disclosure website.

We considered proposing other electronic filing platforms, either maintained by the Commission or by a third-party contractor. We are proposing IARD and EDGAR because they are familiar filing systems for investment advisers and broker-dealers. Investment advisers registered with the Commission file Form ADV on IARD.[318] Many broker-dealers submit documents to the Commission on EDGAR and all broker-dealers have an EDGAR CIK number.[319] As mentioned above, a dual registrant would be required to file the relationship summary on EDGAR and IARD. The information for dual registrants would be accessible through IARD or EDGAR, which are both available through the Commission's website *www.Investor.gov*. Exact processes for firms to follow in filing under each system is specified on the IARD system website and in the EDGAR filer manual, respectively.

There are several reasons we propose having the relationship summaries filed with the Commission. First, every relationship summary would be easily accessible through the Commission's website. The public would benefit by being able to use a central location to find any firm's relationship summary. Easy access to various relationship summaries through one source may facilitate simpler comparison across firms. Second, some firms may not maintain a website, and therefore their relationship summaries would not otherwise be accessible to the public. Although we are proposing that firms without a website include a toll-free telephone number in their relationship summaries that retail investors can call to obtain up-to-date information,[320] requiring filing with the Commission will allow the public to access any firm's relationship summary. Lastly, by having firms file the relationship summaries with the Commission, the Commission can more easily monitor the filings for compliance with Form CRS.

2. Delivery Requirements

We propose to require that a firm deliver the relationship summary to each retail investor, in the case of an investment adviser, before or at the time the firm enters into an investment advisory agreement or, in the case of a broker-dealer, before or at the time the retail investor first engages the firm's services.[321] A dual registrant should deliver the relationship summary at the earlier of entering into an investment advisory agreement with the retail investor or the retail investor engaging the firm's services.[322] We encourage delivery of the relationship summary far enough in advance of a final decision to engage the firm to allow for meaningful discussion between the financial professional and retail investor, including by using the Key Questions, and for the retail investor to understand the information and weigh the available options. The delivery requirement

[314] Much of the disclosure in Part 2A addresses an investment adviser's conflicts of interest with its clients, and is disclosure that the adviser, as a fiduciary, must make to clients in some manner regardless of the form requirements. *See* Brochure Adopting Release, *supra* note 157, at 9.

[315] Form ADV Part 2B includes information about certain advisory personnel on whom clients may rely for investment advice, including their educational background, disciplinary history, and the adviser's supervision of the advisory activities of its personnel. Investment advisers are not required to file with the Commission the brochure supplements required by Form ADV Part 2B. Advisers Act rules 203–1(a), 204–1(b).

[316] IAPD is available at *https://www.adviserinfo.sec.gov*.

[317] *See* proposed amended Advisers Act rule 203–1 note to paragraph (a)(1); proposed Exchange Act rule 17a–14(a), (b). *See infra* Section II.C.2 for a discussion of the delivery requirements.

[318] Investment advisers may instead file a paper copy of the Form ADV with the Commission if they apply for a hardship exemption by filing Form ADV–H.

[319] During fiscal year 2017, approximately 1,100 broker-dealers submitted documents to the Commission using EDGAR. Broker-dealers can file their annual reports on EDGAR and broker-dealers that also conduct another business activity (*e.g.,* broker-dealers that are also municipal advisers or large traders) use EDGAR for other required filings.

[320] Proposed General Instruction 8.(a) to Form CRS.

[321] Advisers Act proposed rule 204–5(b)(1) and Exchange Act proposed rule 17a–14(c)(1); proposed General Instruction 5.(b) to Form CRS.

[322] Advisers Act proposed rule 204–5(b)(1) (investment advisers or their supervised persons must deliver to each retail investor a current Form CRS before or at the time the investment adviser enters into an investment advisory contract with the retail investors) and Exchange Act proposed rule 17a–14(c)(1) (broker-dealers must deliver to each retail investor a current Form CRS before or at the time the retail investor first engages the broker-dealer's services). *See also* proposed General Instruction 5.(b) to Form CRS.

applies to investment advisers even if the investment advisory agreement is oral, and to broker-dealers even if a transaction is executed outside of an account or without an account opening agreement, as further discussed below. In the case of paper delivery, if firms do not deliver the relationship summary as the sole document, firms should ensure that it is the first among any documents that are delivered at that time.[323] A firm would be permitted to deliver the relationship summary (including updates) electronically, consistent with the Commission's guidance regarding electronic delivery.[324] We are also proposing a requirement for firms that maintain a public website to post their relationship summaries on their websites in a way that is easy for retail investors to find.[325] Firms that do not maintain a website would be required to include in their relationship summaries a toll-free number for investors to call to obtain documents.[326]

The timing of the initial delivery of the relationship summary for investment advisers generally tracks that of Form ADV Part 2A.[327] The requirement for broker-dealers is intended to capture the earliest point in time at which a retail investor engages the services of a broker-dealer, including instances when a customer opens an account with the broker-dealer, or effects a transaction through the broker-dealer in the absence of an account, for example, by purchasing a mutual fund through the broker-dealer via ''check and application.'' [328] We believe that providing the retail investor the relationship summary at this first juncture would better assist the retail investor in making a determination whether to open an account with a broker-dealer. The rule does not require delivery to a retail investor to whom a broker-dealer makes a recommendation, if that retail investor does not open or have an account with the broker-dealer, or that recommendation does not lead to a transaction with that broker-dealer. If the recommendation leads to a transaction with the broker-dealer who made the recommendation, we would consider the retail investor to be ''engaging the services'' of that broker-dealer at the time the customer places the order or an account is opened, whichever occurs first.

In addition, a firm would be required to provide a relationship summary to an existing client or customer who is a retail investor before or at the time a new account is opened or changes are made to the retail investor's account(s) that would materially change the nature and scope of the firm's relationship with the retail investor.[329] Such changes would include a recommendation that the retail investor transfer from an investment advisory account to a brokerage account or from a brokerage account to an investment advisory account, or move assets from one type of account to another in a transaction that is not in the normal, customary, or already agreed course of dealing.[330] A move of assets from one type of account to another in a transaction not in the normal, customary, or already agreed course of dealing could include, for example, asset transfers due to an IRA rollover; deposits or the investment of monies based on infrequent events or unusual size, such as an inheritance or receipt from a property sale; or a significant migration of funds from savings to an investment account. If a firm does not have any retail investors to whom it must deliver a relationship summary, it would not be required to prepare one.[331] A firm would be required to deliver the relationship summary to a retail investor within 30 days upon request.[332]

We are proposing different triggers for initial delivery of the relationship summary by investment advisers (before or at the time the firm enters into an investment advisory agreement with the retail investor) and by broker-dealers (before or at the time the retail investor first engages the firm's services). These proposed requirements are intended to make the relationship summary readily accessible to retail investors at the time when they are choosing investment services and are generally consistent with the approach many commenters recommended.[333] In addition, the trigger for investment advisers is consistent with current requirements for investment advisers to deliver the Form ADV Part 2 brochure.[334] A few commenters suggested that disclosures be delivered before a broker-dealer first executes a transaction based on a recommendation to a retail investor.[335] Along these lines, we believe that retail investors should receive the relationship summary as part of the process of engaging the services of a financial professional or firm so the retail investor has the relevant information to make that decision.[336] In particular, because broker-dealers are not required to enter into a formal agreement with a customer in order to provide services, there may be instances in which retail investors engage the services of a broker-dealer without (or before) formally opening a brokerage account (*e.g.,* by entering an agreement

[323] Proposed General Instruction 8.(c) to Form CRS.

[324] *See* Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Exchange Act Release No. 37182 (May 9, 1996) [61 FR 24644 (May 15, 1996)] (''96 Guidance''). *See also* Use of Electronic Media, Exchange Act Release No. 42728 (Apr. 28, 2000) [65 FR 25843 (May 4, 2000)] (''2000 Guidance''); and Use of Electronic Media for Delivery Purposes, Exchange Act Release No. 36345 (Oct. 6, 1995) [60 FR 53458 (Oct. 13, 1995)] (''95 Guidance'').

[325] Advisers Act proposed rule 204–5(b)(3) and Exchange Act proposed rule 17a–14(c)(3); proposed General Instruction 8.(a) to Form CRS.

[326] Proposed General Instruction 8.(a) to Form CRS.

[327] *See* Instruction 1 of General Instructions for Part 2A of Form ADV.

[328] The obligation for a broker-dealer to deliver a relationship summary is broader than the proposed application of Regulation Best Interest, which would apply when a broker-dealer provides a recommendation. *See supra* note 29. Broker-dealers and investment advisers that offer online services would be required to provide the relationship summary to retail investors even if the only services provided to the customer or client is to offer a choice of investment options from an online menu of products, *i.e.,* even if the broker-dealer does not provide a recommendation, provided that the retail investor engages its services. *See also infra* note 337 and accompanying text.

[329] Advisers Act proposed rule 204–5(b)(2) and Exchange Act proposed rule 17a–14(c)(2); proposed General Instruction 7.(a) to Form CRS.

[330] Advisers Act proposed rule 204–5(b)(2) and Exchange Act proposed rule 17a–14(c)(2); proposed General Instruction 7.(a) to Form CRS.

[331] Proposed General Instruction 5.(a) to Form CRS.

[332] Advisers Act proposed rule 204–5(b)(5) and Exchange Act proposed rule 17a–14(c)(5); proposed General Instruction 7.(b) to Form CRS.

[333] Many commenters suggested that the document be provided at the beginning of the relationship with a firm; such as before or at the time the retail investor enters into the agreement. *See, e.g.,* Stifel 2017 Letter; Equity Dealers of America 2017 Letter; Fidelity 2017 Letter; AARP 2017 Letter; State Farm 2017 Letter; AFL–CIO 2017 Letter; CFA 2017 Letter; Wells Fargo 2017 Letter.

[334] An investment adviser is required to give a firm brochure to each client before or at the time the adviser enter into an advisory agreement with that client. *See* Advisers Act rule 204–3(b).

[335] *See, e.g.,* SIFMA 2017 Letter.

[336] *See, e.g.,* 917 Financial Literacy Study, *supra* note 20, at iv (''Generally, retail investors prefer to receive disclosures before making a decision on whether to engage a financial intermediary or purchase an investment product or service.''); Equity Dealers of America 2017 Letter, at 2 (''[W]e believe that [a relationship summary] should be a pillar to any new standard when establishing a new brokerage or advisory account relationship . . . Whether a client wants incidental advice, the ability to provide their own investment ideas or to direct their own transactions as associated with a brokerage account or whether a client wants ongoing advice, monitoring, and a level fee as associated with an advisory account will determine the type of account they choose.''); State Farm 2017 Letter; AARP 2017 Letter; AFL–CIO 2017 Letter, at 3 (''If [a proposed enhanced standard of conduct] were supplemented by pre-engagement disclosures that briefly and clearly describe the sales nature of the broker's services, . . . investors would be modestly better off than they are today.''); Fidelity 2017 Letter; Kiley 2017 Letter; CFA 2017 Letter.

with the broker-dealer). For example, some broker-dealers assist their customers in purchasing mutual funds or variable insurance products to be held with the mutual fund or variable insurance product issuer, by sending checks and applications directly to the fund or issuer (this is sometimes referred to as ''check and application,'' ''application-way,'' ''subscription-way'' or ''direct application'' business; we use the term ''check and application'' for simplicity).[337] In light of these types of circumstances, we are proposing to require broker-dealers to deliver the relationship summary before or at the time the retail investor first engages the firm's services. As noted above, we would not interpret the term ''engage the firm's services'' to capture a recommendation by a broker-dealer to a retail investor who does not already have an account with that broker-dealer, if that recommendation does not lead to a transaction with that broker-dealer.

We also believe that retail investors who are existing clients and customers should be reminded of the information highlighted in the relationship summary before or at the time (i) a new account is opened that is different from the retail investor's existing account(s); or (ii) changes are made to the retail investor's existing accounts that would materially change the nature and scope of the firm's relationship with the retail investor.[338] For example, firms would be required to provide a current version of the relationship summary before or at the time a recommendation is made that the retail investor transfers from an investment advisory account to a brokerage account, transfers from a brokerage account to an investment advisory account, or moves assets from one type of account to another in a transaction not in the normal, customary or already agreed course of dealing.[339] In these instances, retail investors are again making decisions about whether to invest through an advisory account or a brokerage account and would benefit from information about the different services and fees that the firm offers to make an informed choice. Therefore, we are proposing that firms be required to deliver the relationship summary to existing retail investors before or at the time these changes occur. Whether a change would require delivery of the relationship summary would depend on the specific facts and circumstances.[340] For example, transfers among accounts that occur in the ordinary course of business, such as a periodic rebalancing of assets among two accounts or quarterly investments in a retirement account, would not require the delivery of a relationship summary.[341]

As with other disclosures firms must deliver, firms would be able to deliver the relationship summary (including updates) electronically, within the framework of the Commission's guidance regarding electronic delivery of documents.[342] The Commission's previously issued guidance applicable to electronic delivery of certain documents by investment advisers and broker-dealers consists of the following elements: (i) Notice to the investor that information is available electronically; (ii) access to information comparable to that which would have been provided in paper form and that is not so burdensome that the intended recipients cannot effectively access it; and (iii) evidence to show delivery, *i.e.,* reason to believe that electronically delivered information will result in the satisfaction of the delivery requirements under the federal securities laws.[343]

We believe that retail investors who are prospective clients or customers of a firm would benefit from receiving the relationship summary as early as possible when engaging the services of a financial professional or firm, so the retail investor has the relevant information to make that decision. Further to that goal, and in an effort to provide flexibility and recognize the proliferation of means of electronic communications that firms and retail investors may utilize, a firm would be able to deliver the relationship summary to new or prospective clients or customers in a manner that is consistent with how the retail investor requested information about the firm or financial professional.[344] This method of initial delivery for the relationship summary would be consistent with the Commission guidance.[345] With respect to existing clients or customers, firms should deliver the relationship summary in a manner consistent with the firm's existing arrangement with that client or customer and with the Commission guidance.

In connection with account openings conducted online, the Commission previously stated in its 2000 Guidance that broker-dealers could obtain consent from a new customer to electronic delivery of documents through an account-opening agreement that contains a separate section with a separate e-delivery authorization, or through a separate document altogether.[346] The Commission noted that a global consent to e-delivery would not be an informed consent if the opening of a brokerage account were conditioned upon providing the consent; in such cases other evidence of delivery would be required.[347] However, the 2000 Guidance made an exception for brokerage firms that require accounts to be opened online and all account transactions to be initiated and conducted online, stating, ''In these instances only, the opening of a brokerage account may be conditioned upon providing global consent to electronic delivery.'' [348] We understand that for some robo-advisers, the account opening process and subsequent investment decisions and transactions may involve similarly limited interaction with a financial professional. Therefore, it would be consistent with the Commission's prior guidance if firms that offer only online account openings and account transactions, including robo-advisers and online broker-dealers, made global consent to electronic delivery a condition of account opening, for purposes of delivering the relationship summary.

We request comment on whether the Commission should provide additional guidance with respect to electronic delivery of the relationship summary to

[337] The broker-dealer is typically listed as the broker-dealer of record on the retail investor's account application, and generally receives fees or commissions resulting from the retail investor's transactions in the account. *See, e.g.,* Transfers of Mutual Funds and Variable Annuities, FINRA Notice to Members 04–72 (Oct. 2004), *available at http://www.finra.org/sites/default/files/NoticeDocument/p011634.pdf. See also supra* note 328 and accompanying text.

[338] Advisers Act proposed rule 204–5(b)(2) and Exchange Act proposed rule 17a–14(c)(2); proposed General Instruction 7.(a) to Form CRS.

[339] *Id.*

[340] *Id.*

[341] *Id.*

[342] Proposed General Instruction 8.(b) to Form CRS. *See* 96 Guidance, *supra* note 324.

[343] 96 Guidance, *supra* note 324.

[344] For example, a retail investor without access to a computer or email would likely request information in person or by telephone, and the financial professional would deliver a hard copy of the relationship summary in person or by mail.

[345] Firms could meet the elements of the Commission's electronic delivery guidance in other ways as well when delivering the relationship summary to new or prospective clients or customers. *See* 2000 Guidance, *supra* note 324, at 65 FR 25845–46; 96 Guidance, *supra* note 324, at 61 FR at 24647; 95 Guidance, *supra* note 324, at 60 FR at 53461.

[346] 2000 Guidance, *supra* note 324, at 65 FR 25846.

[347] *Id.* Evidence of delivery could include, for example: Obtaining evidence that an investor actually received the information such as by electronic mail return receipt or confirmation of access, downloading, or printing; an investor's accessing a document with hyperlinking to a required document; or using other forms or material available only by accessing the information. *See* 1995 Guidance, *supra* note 324, at section II.C.

[348] *Id.* at n.27.

new and prospective or existing clients and customers.

3. Updating Requirements

The relationship summary is designed to provide information to assist retail investors in making a decision about whether to engage a firm and open a particular type of account, but it is also important for retail investors to know when there have been changes to this information to inform their continuing choice to keep their account with the firm. For example, as noted above, the staff's 917 Financial Literacy Study indicates that retail investors find the nature and scope of a firm's services, its fees and conflicts of interest, and the disciplinary history of financial professionals to be important in choosing financial intermediaries.[349] To the extent that this information changes in a material way, existing clients and customers should be made aware so that they can decide whether the choice of that particular firm or financial professional remains appropriate and consistent with their decision-making criteria. Therefore, we are proposing to require a firm to update its relationship summary within 30 days whenever the relationship summary becomes materially inaccurate.[350] Firms also would be required to post the latest version on their websites (if they have one), and electronically file the relationship summary with the Commission.[351] We believe this approach is consistent with the current requirements for investment advisers to update the Form ADV Part 2 brochure,[352] and with broker-dealers' current obligations, including to update Form BD if its information is or becomes inaccurate for any reason, which information generally would be made available through EDGAR.[353] We believe allowing 30 days for firms to make updates provides sufficient time for firms to make the necessary changes and gives the benefit of certainty of when the updates must be made.

Our proposal would also require firms to communicate without charge the information in an amended relationship summary to retail investors who are existing clients or customers of the firm within 30 days after the updates are required to be made.[354] Firms could communicate this information by delivering the amended relationship summary or by communicating the information another way to the retail investor.[355] For example, if an investment adviser communicated a material change to information contained in its relationship summary to a retail investor by delivering an amended Form ADV brochure or Form ADV summary of material changes containing the updated information, this would support a reasonable belief that the information had been communicated to the retail investor, and the investment adviser would not be required to deliver an updated relationship summary to that retail investor. This requirement provides firms the ability to disclose changes without requiring them to duplicate disclosures and incur additional costs. A retail investor also would be able to find the latest version of the relationship summary on the firm's website, if it has one, and firms would be required to deliver it upon the retail investor's request.[356]

For purposes of this requirement, it is important that broker-dealers identify their existing customers who are retail investors and recognize that a customer relationship may take many forms. For example, under this requirement, a broker-dealer would be required to provide the relationship summary to customers who have so-called ''check and application'' arrangements with the broker-dealer, under which a broker-dealer directs the customer to send the application and check directly to the issuer. We believe this approach would facilitate broker-dealers building upon their current compliance infrastructure in identifying existing customers[357] and would enhance investor protections to retail investors engaging the financial services of broker-dealers.

Finally, our proposal would require a firm to file its relationship summary with the Commission and to maintain the relationship summary and all updates as part of its books and records and make it available to Commission staff upon request, as discussed in Section IV below.[358]

We request comment on filing, delivery, and updating requirements generally, and on the following areas specifically:

• Does this approach to filing, delivery, and updating create unique challenges for firms that are providing the relationship summary electronically? Does this approach provide retail investors with ready access to the information that they need and want in connection with the decision to engage a broker-dealer or investment adviser?

• Should a relationship summary be required for all investment advisers, broker-dealers and dual registrants that provide services to retail investors, or should there be any exceptions? For example, should execution-only broker-dealers be excluded from the requirement to provide the relationship summary because they do not provide investment advice to their customers? Should clearing broker-dealers be excluded from the requirement to prepare and deliver the relationship summary to the extent their customers are introduced by an introducing broker-dealer pursuant to a clearing agreement? If so, why? Should the Commission consider any other exclusions for clearing broker-dealers or other entities? If so, why?

• Should a clearing broker-dealer and introducing broker-dealer be allowed to agree to allocate the responsibility to deliver the relationship summary pursuant to applicable self-regulatory rules?[359] Should investment advisers with sub-advisory relationships be allowed to receive the relationship summary, and any updated information in relationship summaries, from the

[349] *See* 917 Financial Literacy Study, *supra* notes 20–21 and accompanying text.

[350] Advisers Act proposed rule 204–1(a)(2) and Exchange Act proposed rule 17a–14(b)(3); proposed General Instruction 6.(a) to Form CRS.

[351] Advisers Act proposed rules 203–1(a)(1), 204–5(b)(3) and Exchange Act proposed rule 17a–14(b)(2), 17a–14(c)(3); proposed General Instructions 5.(a), 6.(c) and 8 to Form CRS.

[352] *See, e.g.,* Advisers Act proposed rule 204–5(b)(4) and Exchange Act proposed rule 17a–14(a)(3); proposed General Instruction 6 to Form CRS. Generally, an investment adviser registered with the SEC or a state securities authority is required to amend its Form ADV promptly if information it provided in its brochure becomes materially inaccurate. *See* Advisers Act rule 204–1(a)(2); Instruction 4 of General Instructions to Form ADV.

[353] *See, e.g.,* Exchange Act rule 15b3–1.

[354] Advisers Act proposed rule 204–5(b)(4) and Exchange Act proposed rule 17a–14(c)(4); proposed General Instruction 6.(b) to Form CRS.

[355] *Id.*

[356] Advisers Act proposed rules 204–5(b)(3) and 204–5(b)(5) and Exchange Act proposed rules 17a–14(c)(3) and 17a–14(c)(5); proposed General Instructions 7 and 8 to Form CRS.

[357] For example, broker-dealers may already have compliance infrastructure to identify customers pursuant to FINRA's suitability rule, which applies to dealings with a person (other than a broker or dealer) who opens a brokerage account at a broker-dealer or who 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 custodial agent, or using another similar arrangement. *See* Guidance on FINRA's Suitability Rule, FINRA Regulatory Notice 12–55 (Dec. 2012), at Q6(a), *available at http://finra.complinet.com/net_file_store/new_rulebooks/f/i/FINRANotice12_55.pdf.*

[358] *See* Advisers Act proposed rule 204–2(a)(14)(i) and Exchange Act proposed rule 17a–3(a)(24).

[359] *See, e.g.,* FINRA Rule 4311(c) (Carrying Agreements) (requiring each carrying agreement in which accounts are to be carried on a fully disclosed basis to specify the responsibilities of each party to the agreement), available at *http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=10028.*

sub-advisers, on behalf of the primary investment adviser's clients? Should such clients receive the relationship summary of the sub-adviser?

• Should the relationship summary be required in addition to firms' existing disclosure requirements, as proposed? Is the relationship summary duplicative of or does it conflict with any existing disclosure requirements in any way? What, if any, changes would we need to make to the relationship summary if we were to permit its delivery in lieu of other disclosures and why would those changes be appropriate? Should the Commission instead make any changes to existing rules to permit the relationship summary to serve as the venue for disclosures required by those rules?

• Should investment advisers that deliver a relationship summary have different delivery requirements for the Form ADV brochure and brochure supplement?

• Is IARD the optimal system for investment advisers to file Form CRS with the Commission? Is EDGAR the optimal system for broker-dealers to file Form CRS with the Commission? Should dual registrants be required to file on both EDGAR and IARD? [360] Should broker-dealers instead be required to file Form CRS solely through IARD? What would be the costs or benefits associated with broker-dealers becoming familiar with and filing through IARD system rather than through EDGAR? Is there another method of electronic filing the Commission should consider for Form CRS and why? If broker-dealers should file using a system other than EDGAR, what would be the costs and benefits associated with creation of, and/or becoming familiar with and filing through, that system? Should investment advisers and broker-dealers be required to file on the same system?

• How important to investors and other interested parties is the fact that IAPD serves as the single public disclosure website to access an adviser's current filings with the Commission, and compare certain filings of other advisers? What would be the impact of retail investors having to access a separate website for the relationship summary?

• How should the relationship summary be filed? Should it be filed as a text-searchable PDF, similar to how Form ADV is currently filed? Would a structured PDF, a web-fillable form, HTML, XML, XBRL, Inline XBRL or another format be more appropriate, and why? Should the Commission require a single, specified format for all firms, require one format for EDGAR filings and another format for IARD filings, or permit filers to select from two or more possible formats? Would retail investors use the relationship summary to obtain information about one particular firm, or to compare information among firms? What type of format would make it easier for retail investors to use the relationship summary in these ways? For example, would retail investors seek to compare the information about fees across a number of firms, and if so, would a structured format, such as XML or Inline XBRL or an unstructured format, such as PDF or HTML, better facilitate such a comparison? Which filing formats would illustrate the formatting of relationship summaries that are provided electronically, for example, relationship summaries sent in the body of an email, posted on the firm's website, or formatted for a mobile device? Which formats might be most beneficial to retail investors?

• What time or expense is associated with particular formats? What time or expense would be required of the public to view disclosures in a particular format? Would open source, freely available formats be preferred by users and filers, or would commercial proprietary formats be preferred? Would a particular format require any filers or users to license commercial software they otherwise would not, and, if so, at what expense? Would a particular format or formats provide more or fewer features with respect to comparability, reusability, validation, or analysis? What other considerations are related to specific formats? Would a particular format make it possible to confirm that a firm complied with the Form CRS requirements and validate the information provided before filing? If so, which format would filers or users find the most useful?

• We propose to require that an investment adviser deliver the relationship summary before or at the time the firm enters into an investment advisory agreement with a retail investor or, in the case of a broker-dealer, before or at the time the retail investor first engages the firm's services. Would this requirement give a retail investor ample time to process the information and ask questions before entering into an agreement? Or should we require that the relationship summary be delivered a certain amount of time before the firm enters into an agreement with a retail investor (*e.g.,* 48 hours or a 15 minute waiting period)? For broker-dealers, should we require delivery of the relationship summary at the earlier of a recommendation or engagement, as opposed to just engagement? We also propose that a broker-dealer would not need to deliver the relationship summary to a retail investor to whom a broker-dealer makes a recommendation, if that retail investor does not open or have an account with the broker-dealer, or that recommendation does not lead to a transaction with that broker-dealer. Should we instead require that broker-dealers deliver the relationship summary to prospective customers regardless of whether that leads to a transaction or account opening?

• Would the delivery requirements applicable to firms that offer only online account openings, investment advice, and transactions provide sufficient notice to retail investors of the relationship summary's availability and content? Should the Commission require such firms to ensure that the relationship summary is delivered separately from other disclosures, with additional prominence and emphasis? For example, should firms consider employing the technology to require a retail investor to scroll through the entirety of the relationship summary before entering the next stage in the account opening process, accessing a different part of the website in order to obtain more information, or permitting the retail investor to check a box in order to accept the client agreement? Are there other requirements that should be considered for such firms in the delivery of the relationship summary when entering into the brokerage or advisory relationship, when the nature of that relationship changes, or when updates to the relationship summary are made?

• We also propose to require that a firm deliver a relationship summary before or at the time the firm implements changes that would materially change the nature and scope of the existing relationship with a retail investor, for example by the opening of an additional account or accounts and/or the migration of assets from one account type to another. Should the Commission provide more guidance for what might constitute a material change to the nature and scope of the relationship or the moving of a significant amount of assets from one type of account to another? If so, do commenters have suggestions on how the Commission should interpret ''material change to the nature and scope of the relationship'' and ''significant amount of assets''? Should the delivery of the relationship summary under these circumstances be accompanied by additional oral

[360] *See* proposed General Instruction 5.(a) to Form CRS.

disclosures or other types of supplemental information? Would this requirement give retail investors sufficient opportunity to process the information and ask questions before the changes are made? Should we specify how far in advance a firm should deliver the relationship summary before making such changes?

• Should we require that firms deliver an updated relationship summary to retail investors periodically (*e.g.,* quarterly, semi-annually or annually) or whenever there is a material change, as proposed, such as a change in fees or commission structure?

• We propose to require that a firm deliver the relationship summary to a retail investor upon request. Would that requirement be helpful for retail investors? Would that requirement be burdensome for firms? Should we require firms to deliver the relationship summary upon request by *any* investor, not just retail investors and any trust or other similar entity that represents natural persons?

• We propose to require broker-dealers to initially deliver the relationship summary ''before or at the time the retail investor first engages the firm's services.'' Would the proposed formulation capture instances where a retail investor engages the services of a broker-dealer to carry out a transaction outside of an account, for example, by purchasing a mutual fund or variable annuity product through the broker-dealer via ''check and application''? We do not intend to capture instances in which a broker-dealer makes a recommendation to a retail investor who does not already have an account with that broker-dealer, if that recommendation does not lead to a transaction with that broker-dealer. Would such recommendations be captured by the proposed language? Would a different formulation be clearer (*e.g.,* ''before or at the time the retail investor first enters a relationship,'' or ''before or at the time the retail investor engages in a transaction or opens an account, whichever occurs first,'' or ''before or at the time the retail investor indicates an intent to open an account or engage in a transaction, whichever occurs first'')? Why or why not? Should the delivery requirements for investment advisers and broker-dealers be identical? Why or why not?

• For investment advisers, our proposal generally tracks the initial delivery requirements for Form ADV Part 2.[361] Should we instead follow a different disclosure delivery requirement? Should we adopt a different delivery requirement, recognizing that the purpose of the relationship summary is to provide information to retail investors to help them decide whether to engage a particular firm and open an investment advisory or brokerage account?

• We propose to permit firms to deliver the relationship summary electronically consistent with prior Commission guidance on electronic delivery, as discussed above. Is the guidance clear on how firms may meet their obligations with respect to delivering the relationship summary, or should we provide more guidance? Should any additional guidance be more or less prescriptive? Would our proposed approach adequately protect investors who have no internet access or limited internet access or who prefer not to receive information about firms electronically? Is the guidance workable for a disclosure delivered at or before the retail investor enters into an agreement with an investment adviser or first engages the services of a broker-dealer?

• Should we permit firms to meet their relationship summary obligations by filing their relationship summary with the Commission or by posting it online without giving or sending it to specific retail investors?

• Should firms also be required to notify retail investors that an updated relationship summary is available online? Should we require firms to highlight the information that has changed since the prior version in an updated relationship summary? If firms communicate the changes in the relationship summary by means other than delivery of the updated relationship summary, should they be required to inform existing retail investors that the existing version is outdated? Are there additional requirements that we should consider for amendments to relationship summaries, particularly for firms without a website?

• How can we encourage the prominence of the relationship summary for retail investors? We are proposing that, if the relationship summary is delivered on paper and not as a standalone document, firms should ensure that it is the first among any other materials or documents that are delivered at that time. Should we require that the relationship summary be given greater prominence than other materials that accompany it in some other way or that the relationship summary not be bound together with any of those materials? Should we impose additional requirements to encourage the prominence and separateness of the relationship summary? Should we include additional or different requirements for relationship summaries that are delivered electronically? Should we require that the entire text of the relationship summary be provided in the text of an email or other form of electronic messaging, instead of an attachment or a link to the summary disclosure on the firm's website? Are there more dynamic ways to present the relationship summary information online, such as with the use of tool tips, explanatory videos, or chat bots to provide answers to questions? Are there other ways of increasing the prominence of the relationship summary, whether delivered in paper format or electronically?

• Should we require a financial professional to make certain oral disclosures at time of delivery? For example, should we require that a financial professional ask the retail investor if he or she has any questions about the relationship summary? How would this be satisfied in the context of a primarily or exclusively online or electronic delivery?

• Should a firm be required to communicate any material changes made to the relationship summary within 30 days, as proposed, or sooner, for example in the case of transactions not in the normal, customary, or already agreed course of dealing? Should a firm have the option of choosing to communicate the new information by either filing an amended Form CRS or by communicating the new information to retail investors in another way? Should we provide more guidance on the types of ways in which the information may be communicated? Should we instead require a firm to deliver an amended relationship summary to its existing retail investors?

• Are there other changes in conditions that should trigger a delivery requirement?

• We are proposing that firms that do not maintain a website include in their relationship summaries a toll-free phone number for investors to call to obtain documents. Are there additional requirements or different approaches that we should consider for firms that do not maintain websites, to make it easier for the public to access their relationship summaries?

D. Transition Provisions

To provide adequate notice and opportunity to comply with the proposed relationship summary filing requirements, newly registered broker-dealers and new applicants for registration with the Commission as

[361] *See* Advisers Act rule 204–3.

investment advisers would not be required to file or deliver their relationship summaries until the date six months after the effective date of the proposed new rules and rule amendments.[362] After that date, newly registered broker-dealers would be required to file their Form CRS with the Commission by the date on which their registration with the Commission becomes effective, and the Commission would not accept any initial application for registration as an investment adviser that does not include a relationship summary that satisfies the requirements of Form ADV, Part 3: Form CRS.[363]

Similarly, we believe it would be helpful to provide sufficient time for advisers and broker-dealers already registered with us to prepare the new Form CRS and file it electronically with the Commission. Accordingly, we propose to require a broker-dealer that is registered with us as of the effective date of the proposed new rules and rule amendments to comply with the new Form CRS filing requirements by the date that is six months after the effective date of the proposed new rules and rule amendments.[364] We also propose requiring an investment adviser or a dual registrant that is registered with us as of the effective date to comply with the new filing requirements as part of the firm's next annual updating amendment to Form ADV that is required after six months after the rule's effective date.[365] Such an adviser or dual registrant would be required to include Form CRS as part of its next such annual updating amendment filing with the Commission.[366]

We are proposing to require that a firm deliver its relationship summary to all of its existing clients and customers who are retail investors on an initial one-time basis within 30 days after the date the firm is first required to file its relationship summary with the Commission.[367] This proposed requirement would allow existing retail investor clients and customers to receive the important disclosures in the relationship summary that will be provided to new and prospective retail investor customers and clients. A firm would be required to give its relationship summary to its new and prospective clients and customers who are retail investors beginning on the date the firm is first required to electronically file its relationship summary with the Commission, and would be required to give the relationship summary to its existing clients and customers who are retail investors within 30 days, pursuant to the rule's requirements for initial delivery and updating.[368]

We request comment on our proposed implementation requirements.

- Would a six-month period from the effective date of Form CRS provide enough time for newly registered broker-dealers and investment advisers that are filing their initial applications for registration with the Commission to complete Form CRS? If not, please explain why and how much time these advisers and broker-dealers would need to complete Form CRS.
- Should implementation of Form CRS filing requirements for broker-dealers be on a separate timetable from implementation of Form CRS filing requirements for investment advisers, as we have proposed, because registered investment advisers are not all required to file their Form ADV annual updating amendments on the same timetable? If not, please explain why and whether, in order to have one uniform initial filing date for broker-dealers and investment advisers, we should require investment advisers to potentially file their initial Form CRS more than once.
- Should a firm be required to comply with the rule's requirements for initial delivery to new and prospective clients and customers and for updating beginning on the date the firm is first required to electronically file its relationship summary with the Commission, as proposed? Should a firm deliver the relationship summary to all existing clients and customers who are retail investors within 30 days after first filing the relationship summary with the Commission, as proposed? These requirements would result in a different delivery timetable for broker-dealers and investment advisers because investment advisers would file Form CRS with their Form ADV annual updating amendments. Should we instead require all firms to deliver the relationship summary to retail investors beginning on the same date (*e.g.,* within six months from the effective date of Form CRS), even if investment advisers file Form CRS after that date? Or should we require firms to deliver to existing retail investor customers and clients initial relationship summaries at a later date? For example, firms could be required to deliver the relationship summary only before or at the time a new account is opened or changes are made to the retail investor's account(s) that would materially change the nature and scope of the firm's relationship with the retail investor (including before or at the time the firm recommends that the retail investor transfers from an investment advisory account to a brokerage account or from a brokerage account to an investment advisory account, or moves assets from one type of account to another in a transaction not in the normal, customary or already agreed course of dealing).

E. Recordkeeping Amendments

We are also proposing conforming amendments to Advisers Act rule 204–2 and Exchange Act rules 17a–3 and 17a–4, which set forth requirements for maintaining, making and preserving specified books and records, to require SEC-registered investment advisers and broker-dealers to retain copies of each relationship summary.[369] Firms would also be required to maintain each amendment to the relationship summary as well as to make and preserve a record of dates that each relationship summary and each amendment was delivered to any client or to any prospective client who subsequently becomes a client, as well as to any retail investor before such retail investor opens an account.[370] Requiring maintenance of these disclosures as part of the firm's books and records would facilitate the Commission's ability to inspect for and enforce compliance with firms' obligations with respect to Form CRS.

These proposed changes are designed to update the books and records rules in light of our proposed addition of Form ADV Part 3 for registered investment advisers and Form CRS for broker-dealers, and they mirror the current recordkeeping requirements for the Form ADV brochure and brochure supplement. The records for investment advisers would be required to be maintained in the same manner, and for the same period of time, as other books and records required to be maintained under rule 204–2(a), and the records for broker-dealers would be required to

[362] *See* Advisers Act proposed rule 203–1(a)(2) and Exchange Act proposed rule 17a–14(f)(1).

[363] *See* Advisers Act proposed rule 203–1(a)(2) and Exchange Act proposed rule 17a–14(f)(3).

[364] *See* Exchange Act proposed rule 17a–14(f)(1); proposed General Instruction 5.(c)(i) to Form CRS.

[365] *See* Advisers Act proposed rule 204–1(b)(3); proposed General Instruction 5.(c)(i) to Form CRS.

[366] *See id.*

[367] *See* Advisers Act proposed rule 204–5(e)(1) and Exchange Act proposed rule 17a–14(f)(2); proposed General Instruction 5.(c)(iii) to Form CRS.

[368] *See* Advisers Act proposed rule 204–5(e) and Exchange Act proposed rule 17a–14(f)(1), (2); proposed General Instruction 5.(c)(ii), (iii) to Form CRS.

[369] Advisers Act proposed rule 204–2(a)(14)(i); Exchange Act proposed rules 17a–3(a)(24) and 17a–4(e)(10).

[370] *Id.*

maintained for a period of six years.[371] The proposed required documentation, like other records, would be required to be provided to the staff ''promptly'' upon request.[372]

We request comment on these proposed amendments.

• Are there other records related to the relationship summary or its delivery that we should require firms to keep? Should we require them to maintain copies of the relationship summary for a longer or shorter period than we have proposed? Should broker-dealers and investment advisers be required to keep relationship summary-related records for the same amount of time? Should firms be required to document their responses to the ''key questions'' from investors?

III. Restrictions on the Use of Certain Names and Titles and Required Disclosures

As discussed above, both broker-dealers and investment advisers provide investment advice to retail investors, but the regulatory regimes and business models under which they give that advice are different. For example, the principal services, compensation structures, conflicts, disclosure obligations, and legal standards of conduct can differ.[373] We therefore believe that it is vital that retail investors understand whether the firm is a registered investment adviser or registered broker-dealer, and whether the individual providing services is associated with one or the other (or both), so that retail investors can make an informed selection of their financial professional, and then appropriately monitor their financial professional's conduct.

While investors should understand who their financial professional is, and why that matters, studies indicate that retail investors do not understand these differences and are confused about whether their firm or financial professional is a broker-dealer or an investment adviser, or both.[374] Proposed Form CRS, as set out in Section II above, should help to ameliorate this confusion by helping retail investors understand the services that a particular firm offers, and how those services differ based on whether the firm is a registered broker-dealer, registered investment adviser, or both. We preliminarily believe, however, that Form CRS is not a complete remedy for investor confusion. The education and information that Form CRS provides to retail investors could potentially be overwhelmed by the way in which financial professionals present themselves to potential or current retail investors, including through advertising and other communications. This could particularly be the case where the presentation could be misleading in nature, or where advertising and communications precede the delivery of Form CRS and may have a disproportionate impact on shaping or influencing retail investor perceptions.

Specifically, we believe that certain names or titles used by broker-dealers, including ''financial advisor,'' contribute to retail investor confusion about the distinction among different firms and investment professionals, and thus could mislead retail investors into believing that they are engaging with an investment adviser—and are receiving services commonly provided by an investment adviser and subject to an adviser's fiduciary duty, which applies to the retail investors' entire relationship—when they are not.[375] Additionally, broker-dealers and investment advisers, and the financial professionals that are associated with them, currently engage in communications with prospective or existing retail investors without making clear whether they are a broker-dealer or an investment adviser, which can further confuse retail investors if this distinction is not clear from context (whether intentionally or not).

As discussed below, our proposed restriction seeks to mitigate the risk that the names or titles used by a firm or financial professional result in retail investors being misled, including believing that the financial professional is a fiduciary, leading to uninformed decisions regarding which firm or financial professional to engage, which may in turn result in investors being harmed. Additionally, we believe that requiring firms and their associated natural persons or supervised persons to disclose whether the firms are broker-dealers or investment advisers and whether such financial professionals are associated with or supervised by, respectively, such firms would also help to address investor confusion and mitigate potential harm to investors resulting from that confusion. We preliminarily believe that restricting certain persons from using the term ''adviser'' or ''advisor'' coupled with the requirement that firms disclose their regulatory status in retail investor communications would deter potentially misleading sales practices. Investors who understand whether their financial professional or firm is a broker-dealer or investment adviser will be better consumers of the information presented in Form CRS, and less likely to mistakenly obtain the services of a broker-dealer when they intend to engage an investment adviser, or vice versa.[376]

A. Investor Confusion

Over the past decade, various studies have documented that retail investors are confused regarding the services offered by, and the standards of conduct applicable to, broker-dealers and investment advisers, including their use of certain titles.[377]

In 2005, the Siegel & Gale Study found that with respect to titles specifically, ''[r]espondents in all focus groups were generally unclear about the distinctions among the titles brokers, financial advisors/financial consultants, investment advisers, and financial planners . . .'' [378] The following year, the Commission retained RAND to conduct a study of broker-dealers and investment advisers for the purpose of examining, among other things, whether investors understood the duties and obligations owed by investment advisers and broker-dealers.[379] The RAND Study

[371] *See* Advisers Act rule 204–2(e)(1); Exchange Act rule 17a–4(e)(10). Pursuant to Advisers Act rule 204–2(e)(1), investment advisers will be required to maintain the relationship summary for a period of five years, while Exchange Act proposed rule 17a–4(e)(10) would require broker-dealers to maintain the relationship summary for a period of six years.

[372] *See* Advisers Act rule 204–2(g)(2); Exchange Act rule 17a–4(j).

[373] *See, e.g.,* 913 Study, *supra* note 3.

[374] *See, e.g.,* Siegel & Gale Study, *supra* note 5; RAND Study, *supra* note 5; 913 Study, *supra* note 3. Additionally, the RAND Study noted that participants ''commented that the interchangeable titles and 'we do it all' advertisements [by broker-dealers] made it difficult to discern broker-dealers from investment advisers.'' Those participants also stated that these lines were further blurred by the marketing efforts which depicted an ''ongoing relationship between the broker and the investor. . . .'' *See* RAND Study, *supra* note 5, at xix, 19.

[375] *See supra* notes 122 and 216 and accompanying texts.

[376] Section 15(l)(2) of the Exchange Act and section 211(h)(2) of the Advisers Act.

[377] *See, e.g.,* Siegel & Gale Study, *supra* note 5; RAND Study, *supra* note 5; 913 Study, *supra* note 3.

[378] *See* Siegel & Gale Study, *supra* note 5, at 2. The study used focus groups in both Baltimore, MD and Memphis, TN to ''explore investor opinions regarding the services, compensation and legal obligations of several types of financial services professionals.'' *Id.,* at 5.

[379] *See* RAND Study, *supra* note 5, at xiv. In conducting the study, RAND used several methods to study current practices in the financial industry and analyze whether investors understand differences between types of financial service professionals. Among these methods, RAND sent out national household surveys through the internet which studied ''household investment behavior and preferences, experience with financial service providers, and understanding of the different types of financial service providers.'' Additionally, RAND conducted six focus groups with investors in

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noted that ''thousands of firms'' are structured in a variety of ways and provide various different combinations of services and products.[380] The RAND Study concluded that ''partly because of this diversity of business models and services, investors typically fail to distinguish broker-dealers and investment advisers along the lines defined by federal regulations.'' [381]

The RAND Study concluded that, based on interviews with industry representatives, investor surveys, and focus groups, there was generally investor confusion about the distinction between broker-dealers and investment advisers. In particular, ''[interview] participants [in the RAND Study] mentioned that the line between investment adviser and broker-dealers has become further blurred, as much of the recent marketing by broker-dealers focuses on the ongoing relationship between the broker and the investor and as brokers have adopted such titles as 'financial advisor' and 'financial manager.' '' [382] Additionally, participants in RAND's survey believed that financial professionals using the title ''financial advisor'' were ''more similar to investment advisers than to brokers . . .'' [383]

Moreover, focus group participants shed further light on this confusion when they ''commented that the interchangeable titles and 'we do it all' advertisements by broker-dealers made it difficult to discern broker-dealers from investment advisers.'' [384] More specifically, focus group participants observed that ''common job titles for investment advisers and broker-dealers are so similar that people can easily get confused over the type of professional with which they are working.'' [385] The focus group results also showed that when ''[c]omparing beliefs on services provided by investment advisers to services provided by brokers, participants were more likely to say that investment advisers provide advice about securities, recommend specific investments, and provide planning services.'' [386] According to the RAND Study, focus-group participants were more likely to say that brokers rather than investment advisers execute stock transactions and earn commissions and believed ''that investment advisers and brokers are required to act in the client's best interest'' and ''were more likely to say that brokers rather than investment advisers are required to disclose any conflicts of interest.'' [387] In highlighting part of the confusion, the RAND Study noted that the responses from survey participants indicated the opposite conclusion from those of the focus-group participants, namely, that investment advisers are more likely to disclose conflicts of interest.[388]

As discussed above, in light of significant intervening market developments and advances in technology, Chairman Clayton in 2017 invited input on, among other things, investor concerns about the current regulatory framework. Commenters highlighted the risk of harm to investors who obtain services from broker-dealers under the misimpression that they are receiving services protected by the fiduciary duty that applies to investment advisers.[389] For example, one commenter examined the websites of nine different brokerage firms and ''found that the firms' advertising presents the image that the firms are acting in a fiduciary capacity'' with many firm advertisements continuing to present the firm ''as providing all-encompassing advice, with no differentiation between the firms' investment adviser services and brokerage services.'' [390] This commenter also noted that ''[w]ithout uniform standards, persons seeking financial advice are left to fend for themselves in deciding whether their financial advisor is serving two masters or only one, and whether one of those masters is the advisor's financial self-interest.'' [391] In addition, a different commenter argued that the use of certain titles, such as ''advisor,'' should be standardized by the Commission because they are currently ''catch all'' terms for firms with ''wildly different practices, standards, and responsibilities to their clients.'' [392] Some of the commenters to Chairman Clayton's Request for Comment also noted that this confusion is the result of the misleading nature of these titles. Specifically, one commenter stated that ''[t]he problem is that investors are being misled into relying on biased sales recommendations as if they were objective, best interest advice and are suffering significant financial harm as a result.'' [393] The commenter noted that ''these titles and marketing materials are misleading'' [if] . . . broker-dealers truly are the ''mere salespeople they've claimed to be in their legal challenge to the DOL fiduciary rule.'' [394] A different commenter stated that ''a financial professional should not be able to use a title that conveys a standard of conduct to which the professional is not in fact held under the law. . . .'' [395] Additionally, another commenter noted that customer confusion is ''also driven by misleading marketing and misleading titles.'' [396] Finally, one commenter stated that ''having SEC registered entities and their agent, claim such title gives false credence and implies a responsibility which the agent never claims to provide (numerous brokers go by the title 'Financial Advisor', implying Fiduciary standard that is not being upheld).'' [397]

For many years, the Commission has considered approaches for remedying investor confusion about the differing services and obligations of broker-dealers and investment advisers. In particular, in 2005 we considered addressing how investors perceive the differences between broker-dealers and investment advisers by proposing to proscribe the use of certain broker-dealer titles.[398] In adopting our final rule, which was subsequently vacated on other grounds by the Court of

Alexandria, Virginia, and Fort Wayne, Indiana to gain additional evidence on investor beliefs about and experience with financial service providers. RAND also conducted two sets of [in person] interviews: one set of interviews with interested parties and one set with financial service firms. *See* RAND Study, *supra* note 5, at 3-4.

[380] *See* RAND Study, *supra* note 5, at 118.

[381] *Id.*

[382] *See id.,* at 19.

[383] *See id.,* at xix.

[384] *See id.,* at xix. Interview participants also stated that these lines were further blurred by the marketing efforts which depicted an ''ongoing relationship between the broker and the investor. . . .''. *See id.,* at 19.

[385] *See id.,* at 111.

[386] *See id.,* at 109.

[387] *Id.*

[388] *Id.*

[389] *See, e.g.,* CFA 2017 Letter; PIABA 2017 Letter; IAA 2017 Letter; Pefin 2017 Letter; First Ascent 2018 Letter.

[390] *See* PIABA 2017 Letter, at 7. *See also* IAA 2017 Letter, at 11 (''investor confusion persists where certain financial professionals are permitted to use terms such as ''financial adviser'' or ''financial advisor'' that imply a relationship of trust and confidence but, in effect, disclaim fiduciary responsibility for such a relationship''); Pefin 2017 Letter, at 3 (noting that '' 'Investment Advisor' or 'Financial Advisor' are not defined terms, and are currently a ''catch all'' for firms with wildly different practices, standards, and responsibilities to their clients. Many of these firms attempt to imply in external communication that they are a Fiduciary, while disclaiming their responsibilities in the fine print.''); CFA 2017 Letter.

[391] *See* PIABA 2017 Letter, at 17.

[392] *See* Pefin 2017 Letter, at 3. *See also* First Ascent 2017 Letter.

[393] *See* CFA 2017 Letter, at 2.

[394] *See id.,* at 11.

[395] *See* Comment letter of the U.S. Chamber of Commerce (Dec. 13, 2017), at 10.

[396] *See* Comment letter of the Steering Group for the Committee for the Fiduciary Standard (Nov. 8, 2017) (''Committee for the Fiduciary Standard 2017 Letter''), at 3.

[397] *See* Pefin 2017 Letter, at 9.

[398] Certain Broker-Dealers Deemed Not To Be Investment Advisers, Exchange Act Release No. 50980 (Jan. 6, 2005), [70 FR 2716 (Jan. 14, 2005)] (''Broker Dealer Reproposing Release'').

Appeals for the D.C. Circuit,[399] we declined to follow this approach, believing that the better approach was to require broker-dealers to clearly inform their customers receiving investment advice that they are entering into a brokerage, and not an advisory, relationship.[400] However, in light of comments in response to Chairman Clayton's Request for Comment and our experience, we believe that it is appropriate to revisit that approach.

A broker-dealer can, and does, provide investment advice to retail investors without being regulated as an investment adviser, provided that such advice is ''solely incidental to'' its brokerage business and the broker-dealer receives no ''special compensation'' for the advice.[401] While we believe such advice is important for providing retail investors access to a variety of services, products, and payment options, for example, thereby increasing investor choice, we are concerned that use of the terms ''adviser'' and ''advisor'' in a name or title would continue to result in some retail investors being misled that their firm or financial professional is an investment adviser (*i.e.,* a fiduciary), resulting in investor harm. We believe that these terms can obscure the fact that investment advisers and broker-dealers typically have distinct business models with varying services, fee structures, standards of conduct, and conflicts of interest.[402]

It is important for retail investors to better understand the distinction between investment advisers and broker-dealers and to have access to the information necessary to make an informed choice and avoid potential harm. Investor choices of firm type and financial professionals can, for example, affect the extent or type of services received, the amount and type of fees investors pay for such services, and the conflicts of interest associated with any such services. For example, if a retail investor prefers an advisory relationship with an active trading strategy, and he or she mistakenly retains a broker-dealer ''financial adviser,'' this investor potentially could incur more costs if he or she is placed in a brokerage account than he or she would have paid in an advisory account with an asset-based fee. Likewise, an investor could also be misled into believing that the broker-dealer is subject to a fiduciary standard that may not apply,[403] and provides services it may not offer, such as regular monitoring of the account, offering advice on a regular basis, and communicating with the investor on a regular basis.

While we are proposing to require broker-dealers and investment advisers to provide retail investors with a relationship summary that would highlight certain features of an investment advisory or brokerage relationship, that information might be provided *after* the retail investor has initially decided to meet with the firm or its financial professional. The retail investor may make a selection based on such person's name or title. If firms and financial professionals that are not investment advisers are restricted from using ''adviser'' or ''advisor'' in their names or titles, retail investors would be less likely to be confused or potentially misled about the type of financial professional being engaged or nature of the services being received. Conversely, an associated natural person of a broker-dealer using the term ''adviser'' or ''advisor'' may result in an investor believing that such financial professional is an adviser with a fiduciary duty, as discussed in the relationship summary the investor would receive.[404] Similarly, requiring firms and their associated natural persons or supervised persons, as applicable, to disclose whether the firms are broker-dealers or investment advisers would help to address investor confusion and complement the information provided in the proposed relationship summary.

B. Restrictions on Certain Uses of ''Adviser'' and ''Advisor''

We are proposing to restrict any broker or dealer, and any natural person who is an associated person of such broker or dealer, when communicating with a retail investor, from using as part of its name or title the words ''adviser'' or ''advisor'' unless such broker or dealer, is registered as an investment adviser under the Advisers Act or with a state, or any natural person who is an associated person of such broker or dealer is a supervised person of an investment adviser registered under section 203 of the Advisers Act or with a state and such person provides investment advice on behalf of such investment adviser.[405]

1. Firms Solely Registered as Broker-Dealers and Associated Natural Persons

In relevant part, the proposed rule would restrict a broker-dealer's or its associated natural persons' use of the term ''adviser'' or ''advisor'' as part of a name or title when communicating with a retail investor in particular circumstances.[406] This would include names or titles which include, in whole or in part, the term ''adviser'' or ''advisor'' such as financial advisor (or adviser), wealth advisor (or adviser), trusted advisor (or adviser), and advisory (*e.g.,* ''Sample Firm Advisory'') when communicating with any retail investor. In addition, we believe that the proposed rule should apply to communications with retail investors (*i.e.,* natural persons), rather than

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[399] *Financial Planning Association* v. *Securities and Exchange Commission,* 482 F.3d 481 (D.C. Cir. 2007).

[400] As further discussed in the 2005 final rule release, we considered but did not adopt a rule which would have placed limitations on how a broker-dealer may hold itself out or titles it may employ without registering as an investment adviser and complying with the Advisers Act. In deciding to not prohibit the use of specific titles such as ''financial advisor,'' ''financial consultant'' or other similar names, we noted that ''the statutory broker-dealer exception is a recognition by Congress that a broker-dealer's regular activities include offering advice that could bring the broker-dealer within the definition of investment adviser, but which should nonetheless not be covered by the Act.'' As a result, we noted that the ''terms 'financial advisor' and 'financial consultant,' for example, were descriptive of such services provided by broker-dealers.'' We also stated our view that these titles were generic terms that describe what various persons in the financial services industry do, including banks, trust companies, insurance companies, and commodity professionals. *See* 2005 Broker Dealer Release, *supra* note 7; *see also* Broker Dealer Reproposing Release, *supra* note 398.

[401] The Advisers Act regulates the activities of certain ''investment advisers,'' which are defined in section 202(a)(11) as persons who receive compensation for providing advice about securities as part of a regular business. Broker-dealers are excluded from the definition of investment adviser by section 202(a)(11)(C) provided that they meet two prongs: (i) The broker-dealer's advisory services must be ''solely incidental to'' its brokerage business; and (ii) the broker-dealer must receive no ''special compensation'' for the advice.

[402] *See* RAND Study, *supra* note 5, at 18 (''There were also concerns as to what investors understand regarding similarities and differences of brokerage and advisory accounts, the legal obligations of each type of account, and the effect of titles and marketing used by investment professionals on the expectations of investors.'').

[403] *See supra* note 375. *Cf.* Comment letter of Russel Walker (Jun. 17, 207); Comment letter of Jeanne Davis (Jul. 20, 2017); Comment letter of Nancy Lowell (Jul. 20, 2017); Comment letter of John Dalton (Jul. 21, 2017); Comment letter of Nancy Tew (Jul. 21, 2017); Comment letter of Bonitta Knapp (Jul. 21, 2017); Comment letter of Alan Gazetski (Jul. 21, 2017); Comment letter of A. Arias (Jul. 21, 2017); Comment letter of Al Cohen (Jul. 21, 2017); Comment letter of James Melloh (Jul. 21, 2017); Comment letter of Mary Pellecchia (Jul. 21, 2017); Comment letter of William Muller (Jul. 21, 2017); Comment letter of Susan Lee (Jul. 22, 2017); Comment letter of Steve Daniels (Jul. 22, 2017); AARP 2017 Letter; AFL–CIO 2017 Letter; Pefin 2017 Letter; PIABA 2017 Letter; IAA 2017 Letter; CFA 2017 Letter. These commenters argued that as a result of the use of certain titles and communications, retail investors are confused and are erroneously led to believe that their financial professionals are required to act ''in their best interest.''

[404] *See* proposed Item 5.B.3. of Form CRS.

[405] *See* Exchange Act proposed rule 151–2.

[406] *See id.*

institutions, for reasons similar to those detailed above for the relationship summary.[407] Additionally, our proposed rule appropriately applies to retail investors and not to institutions, as institutions generally would be less likely to be misled by such names or titles. The proposed rule, however, would not restrict a broker-dealer's or its associated natural persons' use of the terms ''adviser'' or ''advisor'' when acting on behalf of a bank or insurance company, or when acting on behalf of a municipal advisor or a commodity trading advisor.

We acknowledge that there may be titles other than ''adviser'' or ''advisor'' used by financial professionals that might confuse and thus potentially mislead investors. We considered whether we should restrict broker-dealers from using additional terms, such as, for example, ''financial consultant.'' Given this concern, we focused our proposal on the terms ''adviser'' or ''advisor'' because they are more closely related to the statutory term ''investment adviser.'' Thus, as compared to additional terms such as ''financial consultant,'' ''adviser'' and ''advisor'' are more likely to be associated with an investment adviser and its advisory activities rather than with a broker-dealer and its brokerage activities. Moreover, the term ''investment adviser,'' as compared to terms like ''financial consultant,'' is a defined term under the Advisers Act as any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities.[408] As discussed above, we believe that use of the terms ''adviser'' and ''advisor'' by broker-dealers and their associated natural persons has particularly contributed to investor confusion about the typical services, fee structures, conflicts of interest, and legal standards of conduct to which broker-dealers and investment advisers are subject.[409] Conversely, we preliminarily believe that other terms, even if investors might find them confusing, unclear, or misleading (as some commenters have suggested), do not necessarily imply that a firm or its financial professional is an ''investment adviser'' who would have the principal services, compensation structures, conflicts of interest, disclosure obligations, and legal standards of conduct that are typically associated with being an investment adviser.[410]

Accordingly, we preliminarily do not believe these terms would cause retail investors to believe that their financial professional is an investment adviser when he or she is, in fact, a broker-dealer. We therefore preliminarily believe that restricting use of terms that are similar to ''investment adviser'' appropriately tailors the rule to terms that are likely to result in confusion or mislead retail investors about whether such broker-dealer is an investment adviser and thus a fiduciary.

As we discuss in more detail above, the proposed relationship summary is designed to provide clarity to retail investors regarding information about broker-dealers and investment advisers under a prescribed set of topics (*e.g.,* services, fees, standards of conduct, conflicts). While the proposed relationship summary is designed to help retail investors to distinguish between investment advisers and broker-dealers, we are concerned that the effectiveness of the relationship summary could be undermined if we do not restrict a broker-dealer from using in a name or title the terms ''adviser'' and ''advisor.''

For instance, we preliminarily believe that restricting a broker-dealer or its associated natural persons from using ''adviser'' or ''advisor'' in a name or title would mitigate the risk that a retail investor would be misled into believing and expecting that his or her ''financial advisor,''—who may solely provide brokerage services at a broker-dealer—is an *investment adviser* because of the name or title. For example, if a retail investor were to engage a financial professional with the title ''wealth advisor'' who solely provides brokerage services but who is associated with a dually registered firm,[411] such investor would likely receive the dually registered firm's relationship summary. The relationship summary would include a description of both business models; however, the retail investor could incorrectly match the services he or she would receive from such ''wealth advisor'' to the description in the relationship summary of *investment advisory* services. As a result, the retail investor may be misled to believe that the brokerage services provided by the ''wealth advisor'' are in fact the investment advisory services as described in the relationship summary.

Similarly, a retail investor who engages a financial professional with the title ''wealth advisor'' who is associated solely with a broker-dealer entity would likely receive the broker-dealer's relationship summary, which focuses on the characteristics of the *broker-dealer* business model. As a result, there would be an inconsistency between the description of the broker-dealer business model and the investors' likely perceptions that their professional is an investment adviser. Therefore, the proposed restriction on the use of names or titles would increase the effectiveness of the relationship summary by reducing the risk of a mismatch between investor preferences and type of services received.

We acknowledge that studies have demonstrated that many retail investors select financial professionals and firms based on personal referrals by family, friends, or colleagues.[412] Even if the name or title of the firm or professional may not impact choices made by such investors, we preliminarily believe that the protections offered to other investors by the proposed restriction and disclosure requirements justify the rules.

2. Dually Registered Firms and Dual Hatted Financial Professionals

The proposed rule would permit firms that are registered both as investment advisers (including state-registered investment advisers) and broker-dealers to use the term ''adviser'' or ''advisor'' in their name or title.[413] The proposed

[407] *See supra* note 29 and accompanying text. *See also* Exchange Act proposed rule 151–2(b).

[408] *See* section 202(a)(11)(A) of the Advisers Act, defining an ''investment adviser'' as ''any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.''

[409] *See supra* note 402 and accompanying text. We are not proposing restrictions on names or titles for investment advisers. Our staff is not aware of an investment adviser using a name or title that could cause retail investors to mistakenly believe that such adviser provides brokerage services. Studies and commenters also have not identified retail investor confusion as relating to an investment adviser's use of names or titles. We request comment on our understanding below.

[410] Firms and financial professionals should keep in mind the applicability of the antifraud provisions of the federal securities laws, including section 17(a) of the Securities Act, and section 10(b) of the Exchange Act and rule 10b–5 thereunder, to the use of names or titles. *See also generally* FINRA Rule 2210 (stating in part ''[a]ll retail communications and correspondence must: (A) Prominently disclose the name of the member, or the name under which the member's broker-dealer business primarily is conducted as disclosed on the member's Form BD, and may also include a fictional name by which the member is commonly recognized or which is required by any state or jurisdiction; (B) reflect any relationship between the member and any non-member or individual who is also named; and (C) if it includes other names, reflect which products or services are being offered by the member.'')

[411] For the purposes of Section III, we are defining a ''dually registered firm'' in the same manner as it is defined in the baseline of the Economic Analysis. *See infra* Section IV, note 453.

[412] *See infra* note 546 and accompanying text. *See also* Section IV.A.3.g.

[413] *See* Exchange Act proposed rule 151–2(a)(1).

rule would, however, only permit an associated natural person of a dually registered firm to use these terms where such person is a supervised person of a registered investment adviser *and* such person provides investment advice on behalf of such investment adviser.[414] This would limit the ability of natural persons associated with a broker-dealer who do not provide investment advice as an investment adviser from continuing to use the term ''adviser'' or ''advisor'' simply by virtue of the fact that they are associated with a dually registered firm.[415] We discuss these aspects of the rule in further detail below.

a. Dually Registered Firms

We are not proposing to apply the restriction to dually registered firms. We believe that it is inappropriate to restrict a dually registered firm from using a name or title that accurately describes its registration status. We recognize that under our proposed rule there might be occasions where a dually registered firm provides a particular retail investor only brokerage services, which could lead to some investor confusion.

At the firm level, we do not believe that the determination of when the restriction applies should be based on what capacity a dually registered firm is acting in a particular circumstance, *i.e.,* whether a dually registered firm is acting solely as a broker-dealer and not offering investment advisory services. If we were to apply the restriction in this manner, it could result in firms using multiple names and titles, which may lead to further confusion and create operational and compliance complexities. Accordingly, this could lead to dually registered firms avoiding the use of the title ''adviser'' or ''advisor'' unless they believe they would *always* offer investment advisory services, which we believe is not necessary to avoid the potential investor harm. Additionally, we also seek to avoid the potential misimpression that may result should a firm use a name or title to reflect only its brokerage services and not its investment advisory services. In such a circumstance, a retail investor may not know that such firm offers both business models and could be led to believe that only brokerage services are available.

b. Dual Hatted Financial Professionals

Dual hatted financial professionals of dually registered firms (including state-registered investment advisers) can provide brokerage services, advisory services, or both. We believe it is appropriate for financial professionals that provide services as an investment adviser to retail investors to be permitted to use names or titles which include ''adviser'' and ''advisor,'' even if, as a part of their business, they also provide brokerage services. As such, our proposed rule would not restrict, for example, a financial professional that is both a supervised person of an investment adviser and an associated person of a broker-dealer from using the term ''adviser'' or ''advisor'' in his or her name or title if such person provides investment advice to retail investors on behalf of the investment adviser.[416] We believe that the relationship summary can sufficiently reduce the risk of investors being misled and avoid investor harm because it contains parallel information with respect to each of the services the dual hatted financial professional offers.

By contrast, we recognize that some financial professionals of dually registered firms only provide brokerage services. We are concerned that if these financial professionals use ''adviser'' or ''advisor'' in their names or titles, retail investors may be misled about the nature of services they are receiving, and may incorrectly believe that such person would provide them investment advisory services rather than brokerage services. Therefore, we believe that a financial professional who does not provide investment advice to retail investors on behalf of the investment adviser, *i.e.,* a financial professional that only offers brokerage services to retail investors, should be restricted from using the title ''adviser'' or ''advisor'' despite such person's association with a dually registered firm.

We recognize that, as with dually registered firms, some dual hatted financial professionals may under some circumstances only offer brokerage services to a particular retail investor, which has the potential to cause confusion. For the same reasons discussed above regarding dually registered firms, however, we do not believe that the determination of when the restriction applies should be based on what capacity a dual hatted financial professional is acting in a particular circumstance, *i.e.,* whether a dual hatted professional is offering only brokerage services to that particular investor and not offering investment advisory services.[417] Moreover, we are proposing in Regulation Best Interest to require a broker-dealer to make certain disclosures, including the capacity of the financial professional and firm.[418] We request comment below on whether and if so how the proposed rule should address this particular circumstance.

C. Alternative Approaches

Over the past decade, we and commenters have expressed concern about broker-dealer marketing efforts, including through the use of titles, and whether these efforts are consistent with a broker-dealer's reliance on the exclusion from the definition of investment adviser under section 202(a)(11)(C) of the Advisers Act.[419] Under section 202(a)(11)(C), a broker-dealer is excluded from the definition of investment adviser if its ''performance of [advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor.'' [420] In this regard, and as an alternative to our proposed rule today, we considered proposing a rule which would have stated that a broker-dealer that uses the term ''adviser'' or ''advisor'' as part of a name or title cannot be considered to provide investment advice solely incidental to the conduct of its business as a broker-dealer and therefore is not excluded from the definition of investment adviser under section 202(a)(11)(C). We also considered proposing a rule that would preclude a broker-dealer from relying on the exclusion when such a broker-dealer held itself out as an investment adviser. We are not proposing these alternatives for the reasons discussed below. However, we request comment on these alternatives below.

Our concerns regarding broker-dealer marketing efforts are not new. For example, we have previously requested comment on whether we should preclude broker-dealers from relying on the solely incidental prong of the exclusion if they market their services

[414] *See* Exchange Act proposed rule 151–2(a)(2).

[415] *See* section 202(a)(25) of the Advisers Act [15 U.S.C. 80b–2(a)(25)] defining ''supervised person'' as ''any partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser''.

[416] *See* Exchange Act proposed rule 151–2(a)(2).

[417] *See supra* note 410. Firms and financial professionals should keep in mind the applicability of the antifraud provisions of the federal securities laws, including section 17(a) of the Securities Act, and section 10(b) of the Exchange Act and rule 10b–5 thereunder, to the use of names or titles.

[418] See Regulation Best Interest Proposal, *supra* note 24.

[419] *See, e.g.,* Comment letter of Investment Counsel Association of America (Feb. 7, 2005) (''ICAA 2005 Letter); Comment letter of T. Rowe Price (Feb. 22, 2005) (''T. Rowe Price 2005 Letter'') on Broker Dealer Reproposing Release, *supra* note 398. *See also* Certain Broker-Dealers Deemed Not to Be Investment Advisers, Exchange Act Release No. 42099 (Nov. 4, 1999) (''Release 42099'').

[420] Section 202(a)(11)(C) of the Advisers Act.

in a manner that suggests that they are offering advisory accounts, including through the use of names or titles.[421] While we have never viewed the broker-dealer exclusion as precluding a broker-dealer from marketing itself as providing some amount of advisory services, we have noted that these marketing efforts raised ''troubling questions as to whether the advisory services are not (or would be perceived by investors not to be) incidental to the brokerage services.'' [422] Certain commenters have voiced similar concerns, arguing that the use of certain titles, such as ''financial advisor,'' is inconsistent with the broker-dealer exclusion, with some noting that the marketing of advisory services by a broker-dealer is inconsistent with those services being solely incidental to the brokerage business.[423] Others, however, contended that the titles are consistent with the services provided by broker-dealers, whether in fee-based or commission-based accounts.[424]

Taking into account our concerns and the views of commenters, we considered proposing a rule which would have stated that a broker-dealer that uses the term ''adviser'' or ''advisor'' as part of a name or title would not be considered to provide investment advice solely incidental to the conduct of its brokerage business and therefore would not be excluded from the definition of investment adviser under section 202(a)(11)(C) of the Advisers Act.[425] In considering this alternative, we questioned whether a broker-dealer that uses these terms to market or promote its services to retail investors is doing so because its advice is significant or even instrumental to its brokerage business. Consequently, we questioned whether that broker-dealer's provision of advice is therefore no longer solely incidental to its brokerage business. Similarly, we believe that if a broker-dealer invests its capital into marketing, branding, and creating intellectual property in using the terms ''adviser'' or ''advisor'' in its name or its financial professionals' titles, the broker-dealer is indicating that advice is an important part of its retail investor broker-dealer business. As compared to the more principles-based ''holding out'' approach below, this alternative may offer more certainty and clarity to broker-dealers. It also specifically addresses our concerns about the use of ''adviser'' and ''advisor,'' as discussed in this release.

We also considered a broader approach that would have precluded a broker-dealer from relying on the solely incidental exclusion of section 202(a)(11)(C) if a broker-dealer ''held itself out'' as an investment adviser to retail investors.[426] For example, ''holding out'' could encompass a broker-dealer that represented or implied through any communication or other sales practice (including through the use of names or titles) that it was offering investment advice to retail investors subject to a fiduciary relationship with an investment adviser. As with our alternative approach above, we questioned whether these activities could suggest, or could reasonably be understood as suggesting, that such broker-dealer or its associated natural persons were performing investment advisory services in a manner that was not solely incidental to their business as a broker-dealer. In particular, this approach could reduce the risk that if we restricted certain titles (or limited the use of certain titles used to market services) other potentially misleading titles could proliferate. Certain commenters to Chairman Clayton's Request for Comment also supported this approach, so that retail investors receiving advice from firms ''holding out'' as investment advisers would receive appropriate protections, either under the Advisers Act or through a heightened standard of conduct for broker-dealers.[427] However, we preliminarily believe that a ''holding out'' approach would create uncertainty regarding which activities (and the extent of such activities) would be permissible. Such an approach could also reduce investor choice, as broker-dealers may decide to provide fewer services out of an abundance of caution.

We are not proposing any of these approaches however, because we preliminarily believe that a restriction on the use of ''adviser'' and ''advisor'' in names and titles in combination with the requirement to deliver a relationship summary would be a simpler, more administrable approach to address the confusion about the difference between investment advisers and broker-dealers, and to prevent investors from being potentially misled, compared to the alternatives presented above. While we acknowledge that there are other titles or marketing communications that may contribute to investor confusion or mislead investors, our proposal is tailored toward creating greater clarity with respect to the names and titles that are most closely related to the statutory term investment adviser. In particular, our proposed rule, in combination with the relationship summary, would help distinguish between who is and who is not an investment adviser and allow retail investors to select the business model that best suits their financial goals. The restriction of the use of the terms ''adviser'' and ''advisor'' that we are proposing is intended to augment protections provided to investors by applicable provisions of the federal securities laws. Broker-dealers and their natural associated persons can face liability for intentionally, recklessly, or negligently misleading investors about the nature of the services they are providing through, among other things, materially misleading advertisements or other communications that include statements or omissions, or deceptive practices or courses of business.[428]

We request comment generally on our proposed restriction on the use of certain titles and in particular on the following issues:

- Given the required relationship summary, is it necessary to impose any restrictions on the use of names or titles?
- Do you agree with our proposed restriction on the use of ''adviser'' and ''advisor''? Why or why not? To what extent does the disclosure provided in Form CRS complement our proposed

[421] *See, e.g.,* Release 42099, *supra* note 419.

[422] *See id.*

[423] *See, e.g.,* ICAA 2005 Letter; T. Rowe Price 2005 Letter. *See also e.g.* AFL–CIO 2017 Letter; CFA 2017 Letter; Comment letter of CFA Institute (Jan. 10, 2018); Comment letter of The Committee for the Fiduciary Standard (Jan. 12, 2018).

[424] *See* Broker Dealer Reproposing Release.

[425] As with the proposal, our alternative approach would likewise preclude an associated natural person of a dually registered firm from using the term ''adviser'' or ''advisor'' in a name or title unless he or she is a supervised person of an investment adviser and provides investment advice on behalf of such investment adviser.

[426] *See* AFL–CIO 2017 Letter, at 3 (stating that ''[o]ne way for the SEC to proceed is to clarify that those firms that offer advisory services, or hold themselves out as offering such services, cannot take advantage of the existing broker-dealer 'solely incidental to' exemption from the Investment Advisers Act.''); IAA 2017 Letter; AICPA 2017 Letter.

[427] *See* IAA 2017 Letter, at 11 (''We urge the Commission to address this source of investor confusion by prohibiting firms or individuals from holding themselves out as trusted advisers without being subject to either the Advisers Act fiduciary principles or a new equally stringent best interest standard under the Exchange Act, discussed above.''). *See also, e.g.* AFL–CIO 2017 Letter, at 3 (''clarify that those firms that offer advisory services, or hold themselves out as offering such services, cannot take advantage of the existing broker-dealer ''solely incidental to'' exemption from the Investment Advisers Act. Permitting brokers to rely on this exemption when engaged in advisory activities has had the effect of exempting them from the fiduciary duty appropriate to that advisory role. Adopting this approach would require the SEC to determine what constitutes ''holding out'' as an adviser, addressing marketing practices, as well as job titles, that create the reasonable expectation among investors that they will receive advice and not just sales recommendations.'').

[428] *See, e.g.,* rule 10b–5 under the Securities Exchange Act and section 17(a) of the Securities Act.

restriction? To what extent could it be a substitute?

• Is our approach too broad or too narrow? Are there additional terms that we should explicitly include in the rule? For example, do any of the following names or titles have the potential to confuse investors about the differences between investment advisers and broker-dealers: Wealth manager; financial consultant; financial manager; money manager; investment manager; and investment consultant? Why or why not? What are the names or titles most commonly used that have the potential for investor confusion? Should we consider restricting the use of names, titles, or terms that are synonymous with ''adviser'' or ''advisor'' and if so, what would those names, titles, or terms be?

• Do commenters believe that names or titles are a main factor contributing to investor confusion and the potential for investors to be misled, or are there other more significant factors? For example, do particular services offered by broker-dealers contribute to, or primarily cause, investor confusion and the potential for the broker-dealer's customers to be misled into believing that the broker-dealer is an investment adviser? If so, which services specifically? For example, do commenters believe that retirement and financial planning is more often associated with investment advisers rather than broker-dealers or vice versa? Additionally, do commenters believe that monitoring is more often associated with investment advisers than broker-dealers or vice versa?

• Our proposed rule does not apply to financial professionals of a broker-dealer when acting in the capacity, for example, as an insurance broker on behalf of an insurance company or a banker on behalf of a bank. Do you believe our proposed rule is clear that such persons are excluded from the restriction? If not, how should we provide such clarification?

• As discussed above, our proposed rule would not prohibit dually registered firms from using the term ''adviser'' or ''advisor'' in their name or title. However, it would restrict the use of such names or titles by some associated natural persons and supervised persons of those firms, depending on whether they provide investment advice to retail investors on behalf of the investment adviser. Do you agree with our proposed approach? Is there investor confusion concerning what capacity a dually registered firm, a dual hatted financial professional, or an associated or supervised person of a dually registered firm is acting in when communicating with a retail investor? If such confusion exists, how should we address it, in addition to the proposed relationship summary? For example, are retail investors confused about which type of account their financial professional is referring to when he or she makes a particular recommendation? If this is a source of confusion, how should we address it (*e.g.,* should we address it through affirmative disclosures of account types in account statements or another form of disclosure)?

• Given the prevalence of dually registered firms and their associated dual hatted financial professionals, do retail investors typically believe they are engaging a financial professional who is solely a broker-dealer or investment adviser, or do investors understand that such person is a dual hatted professional and therefore may be able to engage with them as a broker-dealer and an investment adviser? Or do retail investors currently not understand enough to distinguish among these options in any meaningful manner?

• Do commenters believe that retail investors will understand that there is, and will continue to be under proposed Regulation Best Interest, differences in the standards of conduct, compensation structures, and services offered (among other items) depending on the capacity in which such professional engages a retail investor?

• We are proposing to permit or restrict financial professionals associated with dually registered firms from using the term ''adviser'' or ''advisor'' in their name or title based on whether they provide investment advice on behalf of such investment advisers. Are there alternatives we should consider in implementing this portion of the rule? For example, should we only allow a supervised person to use such names or titles where ''a substantial part of his or her business consists of rendering investment supervisory services'' to retail investors, based upon a facts and circumstances determination? [429]

• Our proposed rule would not prohibit dually registered firms or dually hatted financial professionals from using ''adviser'' or ''advisor'' in their names or titles, even in circumstances where the firm or financial professional provides only brokerage services to a particular retail investor. Do you agree with our approach? Why or why not? For example, should the proposed rule's application depend on the capacity in which a financial professional engages a particular retail investor? If so, should financial professionals use multiple titles that would vary based on the capacity in which they are acting, and what titles would they use? Are there compliance challenges associated with this approach? Conversely, would this discourage dually registered firms or dually hatted financial professionals from using any title with ''adviser'' or ''advisor,'' even when they are providing advisory services? Would this discourage dually hatted financial professionals from providing brokerage services? Would a firm use different names or titles for different subsets of their financial professionals?

• Do you agree that the use of the terms ''adviser'' or ''advisor'' by broker-dealers are the main sources of investor confusion? If so, what do these terms confuse investors about (*e.g.,* the differences as to the standard of conduct their financial professional owes, the duration of the relationship, fees charged, compensation)? Are investors harmed by this confusion? If so, how? Do you agree that ''adviser'' and ''advisor'' are often associated with the statutory term ''investment adviser''? Do you believe that retail investors understand what the terms ''adviser'' and ''broker-dealer'' mean and can correctly identify what type of financial professional they have engaged?

• We understand that the terms ''adviser'' or ''advisor'' are included in some professional designations earned by financial professionals.[430] We also understand that particular professional designations have been an area of concern for FINRA and NASAA.[431] Should we include an exception to permit the use of professional designations that use the terms ''adviser'' or ''advisor''? What factors should the Commission consider if it were to include such an exception? For example, should such an exception be conditioned on prominent disclosure

[429] *See* section 208(c) of the Advisers Act: ''[i]t shall be unlawful for any person registered under section 203 of this title to represent that he is an investment counsel or to use the name 'investment counsel' as descriptive of his business unless (1) his or its principal business consists of acting as investment adviser, and (2) a substantial part of his or its business consists of rendering investment supervisory services.''

[430] *See* FINRA, Professional Designations, *available at https://www.finra.org/investors/professional-designations.*

[431] *See* Senior Designations, FINRA Notice 11–52 (Nov. 2011), *available at http://www.finra.org/sites/default/files/NoticeDocument/p125092.pdf*; NASAA, *NASAA Model Rule on the Use of Senior-Specific Certifications and Professional Designations* (Mar. 20, 2008), *available at http://www.nasaa.org/wp-content/uploads/2011/07/3-Senior_Model_Rule_Adopted.pdf.*

that the individual is not an investment adviser or supervised by one?

- Do you agree with the proposed approach in Exchange Act proposed rules 15l–2 and 15l–3 and Advisers Act proposed rule 211h–1 of limiting our proposed rules to ''retail investors'' where such persons are defined to include all natural persons as discussed above? [432] Should we instead exclude certain categories of natural persons based on their net worth or income level, such as accredited investors,[433] qualified clients [434] or qualified purchasers? [435] If we did exclude certain categories of natural persons based on their net worth, what threshold should we use for measuring net worth? Should we exclude certain categories of natural persons for other reasons?
- Should we conform the definition of retail investor to the definition of retail customer as proposed in Regulation Best Interest, which would include non-natural persons, provided the recommendation is primarily for personal, family, or household purposes? What kind of compliance burdens would it create to base Form CRS delivery off of a definition of retail investor that only included recommendations primarily for personal, family, or household purposes? Should the definition of retail investor include trusts or similar entities that represent natural persons, as proposed? Are there other persons or entities that should be covered? Should we expand the definition to cover plan participants in workplace retirement plans who receive services from a broker-dealer or investment adviser for their individual accounts within a plan?
- What costs would broker-dealers impacted by our proposed rule incur as a result of having to rebrand themselves and their financial professionals along with revising their communications? Are there means to mitigate such costs? Would the costs differ if we made the broker-dealer exclusion in the Advisers Act unavailable to broker-dealers that use the terms ''adviser'' or ''advisor''?
- How would broker-dealers and associated natural persons of broker-dealers who would be impacted by our proposed rule change the way they market themselves or communicate with retail investors as a result of our proposed rule? Would this cause any other changes to their business? For example, would more broker-dealer firms also register with the Commission or the states as investment advisers as a result of our proposed rule? Will firms exit the brokerage business as a result of our proposed rule? Would more associated natural persons of broker-dealers become dual hatted?
- Would our proposed rule impact the marketing and communications of dually registered firms and their professionals in any manner? If so, how?
- Do investment advisers and their supervised persons also use names, titles, or professional designations that can lead or contribute to retail investor confusion? If so, please provide examples of these names or titles and how they can lead or contribute to confusion. Should we restrict investment advisers and their supervised persons from using these names or titles?
- What costs would our proposed restriction on certain names and titles impose? Are there greater or lower costs associated with our proposed rules as compared to alternative approaches that consider whether certain titles or marketing practices are consistent with advice being ''solely incidental'' to the firm's brokerage activities and thus permissible for a firm relying on the broker-dealer exclusion from the Advisers Act? If so, what are the specific cost estimates of each approach and the components of those estimates? Are there ways to mitigate their impact and if so, what methods could be taken? Are there operational and compliance challenges associated with our proposed approach as compared to the alternatives approaches, and if so, what are they?
- We request comment on the alternative approach in which a broker-dealer would not be considered to provide investment advice solely incidental to the conduct of its brokerage business if it uses the term ''adviser'' or ''advisor'' to market or promote its services and would instead treat such practices as indicating that the broker-dealer's advisory services are not ''solely incidental'' to its conduct of business as a broker-dealer. What would be the advantages or disadvantages of using this approach instead of the approach we have proposed? Would the alternative approach address and mitigate investor confusion about the differences between broker-dealers and investment advisers? Would the alternative approach reduce the likelihood that investors may be misled as to the type of firm they are engaging with and therefore make an uninformed decision? Would the alternative approach have other effects on the analysis of when advisory activities are or are not solely incidental to brokerage activities? How would this alternative approach impact dually registered firms and dual hatted financial professionals? Are there operational and compliance challenges associated with this approach, and if so, what are they? How would broker-dealers and associated natural persons of broker-dealers impacted by the alternative approach change the way they market themselves or communicate with retail investors as a result of our proposed rule? Would this cause any other changes to their business?
- Would the alternative approach discussed above that would preclude a broker-dealer or an associated natural person of a broker-dealer from relying on the broker-dealer exclusion of section 202(a)(11)(C) of the Advisers Act if it ''held itself out'' as an investment adviser address investor confusion? What would be the advantages or disadvantages of using this approach instead of the approach we have proposed? Which communications or level of advice do you think imply that a broker-dealer or its associated natural person is ''holding out'' as an investment adviser? How would an approach that focuses on ''holding out'' as an investment adviser impact access to advice from different kinds of firms, and how retail investors pay for this advice? How would this approach affect competition? Would this ''holding out'' approach address any confusion that may arise from broker-dealer marketing efforts focusing on the ongoing relationship between the broker and the investor? Are there operational and compliance challenges associated with this approach, and if so, what are they?
- Instead of a prohibition or restriction on the use of certain terms, should we permit such terms but require broker-dealers and their associated natural persons other than dual registrants and dual hatted financial professionals to include a disclaimer in their communications that they are *not* an investment adviser or investment adviser representative, respectively, each time they use or refer to the term ''adviser'' or ''advisor''? Would this approach address investor confusion or mitigate the likelihood that investors may be misled when broker-dealers and their associated natural persons use the term ''adviser'' or ''advisor''? Should this approach be coupled with an affirmative obligation that a dually registered broker-dealer or its dual hatted associated natural persons disclose that it is an investment adviser or an investment adviser representative, respectively, when using terms *other than* ''adviser'' or ''advisor''? Would this requirement discourage broker-dealers from using

[432] *See supra* notes 28–32 and accompanying text.

[433] *See supra* note 66.

[434] *See supra* note 67.

[435] *See supra* note 68.

these terms even if they were not prohibited? How would this approach impact our proposed rule requiring disclosure of the firm's regulatory status and the financial professional's association with the firm? How would this approach impact dually registered firms and dually hatted financial professionals? Are there operational and compliance challenges associated with this approach, and if so, what are they?

• We recognize that the term ''adviser'' is used differently in connection with the regulation of investment advisory services provided to workplace retirement plans and IRAs under ERISA and the prohibited transaction provisions of the Internal Revenue Code. For example, a statutory exemption for the provision of investment advice to participants of ERISA-covered workplace retirement plans and IRAs, and related DOL regulations, define the term ''fiduciary adviser'' broadly to include a variety of persons acting in a fiduciary capacity in providing investment advice, including investment advisers registered under the Advisers Act or under state laws, registered broker-dealers, banks or similar financial institutions providing advice through a trust department, and insurance companies, and their affiliates, employees and other agents.[436] Given that there are definitions of ''adviser'' under other federal regulations that capture entities and individuals who are not regulated under the Advisers Act, would a restriction on the use of the term ''adviser'' that applies only to registered broker-dealers and their registered representatives contribute to investor confusion or result in conflicting regulations, and possibly increased compliance burdens, or affect competition?

• What would be the effect on competition by prohibiting broker-dealers from using these terms? What would be the effect on competition by the alternative approaches described?

D. Disclosures About a Firm's Regulatory Status and a Financial Professional's Association

We are also proposing rules under the Exchange Act and the Advisers Act to require a broker-dealer and an investment adviser registered under section 203 to prominently disclose that it is registered as a broker-dealer or investment adviser, as applicable, with the Commission in print or electronic retail investor communications.[437] We are also proposing as part of our proposed Exchange Act rule to require an associated natural person of a broker or dealer to prominently disclose that he or she is an associated person of a broker-dealer registered with the Commission in print or electronic retail investor communications.[438] In addition, we are proposing as part of our Advisers Act rule to require a supervised person of an investment adviser registered under section 203 to prominently disclose that he or she is a supervised person of an investment adviser registered with the Commission in print or electronic retail investor communications.[439] For example, an investment adviser registered with the Commission would prominently disclose the following on its print or electronic communications: ''[Name of Firm], an investment adviser registered with the Securities and Exchange Commission'' or ''[Name of Firm], an SEC-registered investment adviser.'' Dually registered firms would similarly be required to prominently disclose both registration statuses in their print or electronic communications, for example: ''[Name of Firm], an SEC-registered broker-dealer and SEC-registered investment adviser.'' Similarly, an associated natural person of a broker-dealer would prominently disclose the following, for example, on his or her business card or signature block: ''[Name of professional], a [title] of [Name of Firm], an associated person of an SEC-registered broker-dealer.'' Alternatively, a supervised person of an investment adviser would prominently disclose the following on, for example, his or her business card or signature block: ''[Name of professional], a [title] of [Name of Firm], a supervised person of an SEC-registered investment adviser.'' Finally, a financial professional who is both an associated person of a broker-dealer and a supervised person of an investment adviser would prominently disclose the following, for example: ''[Name of professional], a [title] of [Name of Firm], an associated person of an SEC-registered broker-dealer and a supervised person of an SEC- registered investment adviser.''

Our proposed registration disclosure rules, like the proposed restriction on names and titles, or our proposed alternative approaches, complement our proposed requirement that broker-dealers and investment advisers deliver a relationship summary to retail investors. Even if a firm uses various titles, such as ''wealth consultant'' or ''wealth manager,'' the legal term for these firms is ''investment adviser'' and/or ''broker-dealer.'' These statutory terms have meaning because they relate to a particular regulatory framework that is designed to address the nature and scope of the firm's activities, which the firm would describe for a retail investor in the relationship summary.[440] Accordingly, we preliminarily believe that requiring a firm to disclose whether it is a broker-dealer or an investment adviser in print or electronic communications to retail investors would assist retail investors to determine which type of firm is more appropriate for their specific investment needs.

For similar reasons, we preliminarily believe that because retail investors interact with a firm primarily through financial professionals, it is important that financial professionals disclose the firm type with which they are associated. We acknowledge that in the studies and the comments received, retail investors generally believe broker-dealers and investment advisers are similar, and that they did not understand differences between them.[441] As discussed above, while we acknowledge that broker-dealers and investment advisers are similar in that they provide investment advice, they commonly are dissimilar in a variety of key areas such as disclosure of conflicts of interest, types of fees charged, and standard of conduct. In particular, the

[436] *See* ERISA § 408 (g)(11)(A); Code § 4975(f)(8)(J)(i) and 29 CFR 2550.408g–1. In addition, under the DOL's BIC Exemption, the term ''Adviser'' would mean an *individual* who is an employee or other agent (including a registered representative) of a state or federally registered investment adviser, registered broker-dealer, bank or similar financial institution, or an insurance company. *See* Corrected BIC Exemption, *infra* note 504, section VIII(a).

[437] *See* Exchange Act proposed rule 15l–3(a) and Advisers Act proposed rule 211h–1(a). We note that in Form ADV investment advisers are required to state that registration with the Commission does not imply a certain level of skill or training. *See* Item 1.C. of Form ADV Part 2A. We are requesting comment on whether we should require broker-dealers and investment advisers to include this statement in addition to disclosing their applicable regulatory status.

[438] *See* Exchange Act proposed rule 15l–3(b).

[439] *See* Advisers Act proposed rule 211h–1(b).

[440] For similar reasons, we are requiring the use of the terms ''supervised person'' and ''associated person'' as they are defined legal terms generally describing the financial professional's association with the investment adviser or broker-dealer, respectively.

[441] *See supra* Section III.A. *See also, e.g.,* RAND Study, *supra* note 5, at 19, 20 (''Many [industry interview] participants reported that they thought that offering such [fee-based account] products and services meant that broker-dealers and investment advisers became less distinguishable from one another. They claimed that bundling of advice and sales by broker-dealers also added to investor confusion . . . . [Industry Representative] interviews suggest that individual investors do not distinguish between investment advisers and broker-dealers. Marketplace changes that have resulted in investment advisers and broker-dealers offering similar services have added to investor confusion.'').

proposed relationship summary would inform retail investors about many of these differences, and in so doing, would be addressing investor confusion. As a result, even if investors are currently confused, over time they should better understand that investment advisers and broker-dealers may be different, and how they are different.

Similarly, our proposed rules to require a firm to disclose whether it is a broker-dealer or an investment adviser in print or electronic communications to retail investors would help to facilitate investor understanding, even if investors currently may not understand the differences between investment advisers and broker-dealers.

We believe that disclosures that are as important as whether a firm is a broker-dealer or an investment adviser or whether a financial professional is associated with a broker-dealer or is a supervised person of an investment adviser, should not be inconspicuous or placed in fine print. Accordingly, we are proposing to require a firm and its financial professionals to disclose their registration statuses in print communications in a type size at least as large as and of a font style different from, but at least as prominent as, that used in the majority of the communication.[442] To be ''prominent,'' for example, we believe the disclosures should be included, at a minimum, on the front of a business card or in another communication, in a manner clearly intended to draw attention to it. In addition, we are proposing to require the disclosure to be presented in the body of the communication and not in a footnote.[443] If a communication is delivered through an electronic communication or in any publication by radio or television, the disclosure must be presented in a manner reasonably calculated to draw retail investors' attention to it.[444] For example, in a televised or video presentation, a voice overlay and on-screen text could clearly convey the required information. Finally, we propose to stage the compliance date to ensure that firms and financial professionals can phase out certain older communications from circulation through the regular business lifecycle rather than having to retroactively change them.[445]

We request comment generally on our proposed requirement to disclose a firm's regulatory status and, for financial professionals, their association with such firm, and in particular on the following issues:

• Does our proposed rule requiring disclosure of a firm's registration status, either alone or in combination with the proposed relationship summary, sufficiently address the concerns addressed by our proposed restriction on certain names or titles? If not, why not?

• Would the proposed rules requiring disclosure of registration status and the financial professional's association with the firm give retail investors greater clarity about various aspects of their relationship with a financial professional (*e.g.,* his or her services, compensation structures, conflicts of interest, and legal obligations)?

• To what extent do firms already clearly and conspicuously disclose their federal and/or state registration as investment advisers or broker-dealers? To what extent do financial professionals already disclose their association with the broker-dealer or investment adviser? If such status is disclosed, is it typically in fine print or presented in a manner that it is not easily recognizable to investors?

• Do retail investors understand what it means for a firm to be ''registered'' with the Commission or a state? Additionally, do retail investors understand what it means for a financial professional to be an ''associated person'' of a broker-dealer or a ''supervised person'' of an investment adviser?

• Would our proposed rules improve clarity and consistency for investors in identifying a firm's regulatory status and a financial professional's association with a firm or will it lead to unnecessary, wordy, and possibly redundant disclosure? If the latter, how can we address this?

• Are we correct that investors would find it helpful to know whether a firm is registered as an investment adviser or a broker-dealer or a financial professional is associated with a broker-dealer or supervised by an investment adviser so that they can refer to the relationship summary to better understand the practical implications of the firm's registration and such financial professional's association with that firm?

• Should dually registered firms be required to disclose both registration statuses? Would this requirement cause more confusion or help to address it? If so, how? By requiring a financial professional to disclose whether he or she is an associated person of a broker-dealer or a supervised person of an investment adviser, would we be assisting retail investors in understanding the capacity in which their financial professional services them? For example, would retail investors serviced by dual hatted financial professionals understand that their financial professional may act in dual capacities (*i.e.,* brokerage and advisory)?

• Are our proposed requirements prescribing the presentation of the disclosure appropriate? Should we consider removing any of these requirements? Alternatively, are there requirements we should add? If so, which requirements and why? Are there requirements that we should modify? For example, could the Commission's objective of ensuring prominence of disclosure be served through a more principles-based approach, or through different requirements (*e.g.,* that the disclosure be not 20% smaller than the principal text)?

• Should the account statement or other disclosure clarify whether a retail investor has an advisory or a brokerage account? If so, how?

• Should our proposed rules define ''communication''? For example, should we include in the rule a definition that tracks FINRA's definition of ''communication'' in Rule 2210? In particular, FINRA Rule 2210 defines a ''communication'' as correspondence, retail communications and institutional communications. ''Correspondence'' means any written (including electronic) communication that is distributed or made available to 25 or fewer retail investors within any 30 calendar day period and ''Retail communication'' means any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar day period. Finally, ''Institutional communication'' means any written (including electronic) communication that is distributed or made available only to institutional investors, but does not include a member's internal communications. Are there other definitions of ''communication'' we should consider? As an alternative to the word

[442] *See* Exchange Act proposed rule 15l–3(c)(1) and Advisers Act proposed rule 211h–1(c)(1).

[443] *See supra* note 442.

[444] *See* Exchange Act proposed rule 15l–3(c)(2) and Advisers Act proposed rule 211h–1(c)(2). *See also* Proposed Amendments to Investment Company Advertising Rules, Investment Company Act Release No. 25575 (May 17, 2002); Amendments to Investment Company Advertising Rules, Investment Company Act Release No. 26195 (Sept. 29, 2003) (stating that ''radio and television advertisements [must] give the required narrative disclosures emphasis equal to that used in the major portion of the advertisement''). *See also* 17 CFR 230.420.

[445] Similarly, we are not requiring firms to send new communications to replace all older print communications as this would be overly burdensome and costly for firms.

''communication'' in our proposed rules, should we use ''advertisements'' as defined in rule 206(4)–1 under the Advisers Act, or a different term? [446]

• Should the proposed rules apply to all communications to retail investors, including oral communications? On the other hand, are there certain types of written communications that could be exempted, *e.g.* communications that do not make any financial or investment recommendation or otherwise promote a product or service of the member? [447]

• Should we permit the use of hyperlinks to the registration status disclosure statement for electronic communications rather than requiring the disclosure statement on the communication itself? Would permitting hyperlinks limit or promote the effectiveness of this disclosure requirement, and if so, how?

• Should we require broker-dealers, investment advisers and financial professionals to state that registration with the Commission does not imply a certain level of skill or training? Are there potential benefits or drawbacks to requiring this type of statement?

IV. Economic Analysis

We are sensitive to the economic effects, including the costs and benefits that stem from the proposed rules. Whenever the Commission engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, section 3(f) of the Exchange Act requires the Commission to consider whether the action would promote efficiency, competition, and capital formation, in addition to the protection of investors.[448] Further, when making rules under the Exchange Act, section 23(a)(2) of the Exchange Act requires the Commission to consider the impact such rules would have on competition.[449] Section 23(a)(2) of the Exchange Act also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[450]

Section 202(c) of the Advisers Act requires the Commission, when engaging in rulemaking and required to consider or determine whether an action is necessary or appropriate in the public interest, also to consider whether the action will promote efficiency, competition, and capital formation, in addition to the protection of investors.[451] The Commission provides both a qualitative assessment of the potential effects and, where feasible, quantitative estimates of the potential aggregate initial and aggregate ongoing costs. In some cases, however, quantification is particularly challenging due to the difficulty of predicting how market participants would act under the conditions of the proposed rules. For example, although we expect that the proposal would increase retail investors' understanding of the services provided to them, investors could respond differently to the increased understanding—by transferring to a different financial firm or professional, hiring a financial professional for the first time, or entirely abandoning the financial services market while moving their assets to other products or markets (*e.g.,* bank deposits or insurance products). The Commission encourages commenters to provide any data and information that could help us quantify these long-term effects.

In the economic analysis that follows, we first examine the current regulatory and economic landscape to form a baseline for our analysis. We then analyze the likely economic effects—including benefits and costs and impact on efficiency, competition, and capital formation—arising from the proposed rules relative to the baseline discussed below.

A. Baseline

This section discusses, as it relates to this proposal, the current state of the broker-dealer and investment adviser markets, the current regulatory environment, and the current state of retail investor perceptions in the market.

1. Providers of Financial Services

a. Broker-Dealers

As noted above, one market that would be affected by these proposed rules [452] is the market for broker-dealer services, including firms that are dually registered as broker-dealers and investment advisers.[453] The market for broker-dealer services encompasses a small set of large broker-dealers and thousands of small broker-dealers competing for niche or regional segments of the market.[454]

As of December 2017, there were approximately 3,841 registered broker-dealers with over 130 million customer accounts. In total, these broker-dealers have close to $4 trillion in total assets.[455] More than two-thirds of all brokerage assets and close to one-third of all customer accounts are held by the 16 largest broker-dealers, as shown in Table 1, Panel A.[456] Of the broker-dealers registered with the Commission as of December 2017, 366 broker-dealers were dually registered as investment advisers; [457] however, these firms hold nearly 90 million (68%) customer accounts.[458] Approximately 546 broker-

[446] *See* FINRA Rule 2210(a); rule 206(4)–1 under the Advisers Act.

[447] *See* FINRA Rule 2210(b)(1)(D)(iii) (exempting certain communications from principal pre-approval).

[448] *See* 15 U.S.C. 77b(b) and 15 U.S.C. 78c(f).

[449] *See* 15 U.S.C. 78w(a)(2).

[450] *Id.*

[451] 15 U.S.C. 80b–2(c).

[452] ''Proposed rules'' used in this economic analysis is inclusive of Form CRS and related proposed forms as well as the proposed rules themselves.

[453] Not all firms that are dually registered as an investment adviser and a broker-dealer offer both brokerage and advisory accounts to retail investors—for example, some dual registrants offer advisory accounts to retail investors but offer only brokerage services, such as underwriting services, to institutional clients. For purposes of the discussion of the baseline in this economic analysis, a dual registrant is any firm that is dually registered with the Commission as an investment adviser and a broker-dealer. For the purposes of the relationship summary, however, we propose to define dual registrant as a firm that is dually registered as a broker-dealer and an investment adviser and offers services to retail investors as both a broker-dealer and investment adviser. *See supra* note 25.

[454] *See* Risk Management Controls for Brokers or Dealers with Market Access, Securities Exchange Act Release No. 63241 (Nov. 3, 2010) [75 FR 69791, 69822 (Nov. 15, 2010)].

[455] Assets are estimated by Total Assets (allowable and non-allowable) from Part II of the FOCUS filings (Form X–17A–5 Part II, *available at https://www.sec.gov/files/formx-17a-5_2.pdf*) and correspond to balance sheet total assets for the broker-dealer. The Commission does not have an estimate of the total amount of customer assets for broker-dealers. We estimate broker-dealer size from the total balance sheet assets as described above.

[456] Approximately $3.91 trillion of total assets of broker-dealers (98%) are at firms with total assets in excess of $1 billion. Of the 30 dual registrants in the group of broker-dealers with total assets in excess of $1 billion, total assets for these dual registrants are $2.46 trillion (62%) of aggregate broker-dealer assets. Of the remaining 88 firms, 81 have affiliated investment advisers.

[457] Because this number does not include the number of broker-dealers who are also registered as state investment advisers, the number undercounts the full number of broker-dealers that operate in both capacities. Further, not all firms that are dually registered as an investment adviser and a broker-dealer offer both brokerage and advisory accounts to retail investors—for example, some dual registrants offer advisory accounts to retail investors but offer only brokerage services, such as underwriting services, to institutional customers. For purposes of the discussion of the baseline in this economic analysis, a dual registrant is any firm that is dually registered with the Commission as an investment adviser and a broker-dealer.

[458] Some broker-dealers may be affiliated with investment advisers without being dually registered. From Question 10 on Form BD, 2,145 broker-dealers report that directly or indirectly, they either control, are controlled by, or under common control with an entity that is engaged in the securities or investment advisory business. Comparatively, 2,478 (19.57%) SEC-registered investment advisers report an affiliate that is a

Continued

dealers (14%) reported at least one type of non-securities business, including insurance, retirement planning, mergers & acquisitions, and real estate, among others.[459] Approximately 74% of registered broker-dealers report retail customer activity.[460]

Panel B of Table 1 limits the broker-dealers to those that report some retail investor activity. As of December 2017, there were approximately 2,857 broker-dealers that served retail investors, with over $3.6 trillion in assets (90% of total broker-dealer assets) and 128 million (96%) customer accounts.[461] Of those broker-dealers serving retail investors, 360 are dually registered as investment advisers.[462]

TABLE 1—PANEL A: REGISTERED BROKER-DEALERS AS OF DECEMBER 2017 [463]

[Cumulative Broker-Dealer Total Assets and Customer Accounts [464]]

Size of broker-dealer (total assets)	Total number of BDs	Number of dual-registered BDs	Cumulative total assets	Cumulative number of customer Accounts [465]
>$50 billion	16	10	$2,717 bil.	40,969,187
$1 billion to $50 billion	102	20	1,196 bil.	81,611,933
$500 million to $1 billion	38	7	26 bil.	4,599,330
$100 million to $500 million	118	26	26 bil.	1,957,981
$10 million to $100 million	482	94	17 bil.	2,970,133
$1 million to $10 million	1,035	141	4 bil.	233,946
<$1 million	2,055	68	1 bil.	5,588
Total	3,841	366	3,987 bil.	132,348,098

TABLE 1—PANEL B: REGISTERED RETAIL BROKER-DEALERS AS OF DECEMBER 2017

[Cumulative Broker-Dealer Total Assets and Customer Accounts]

Size of broker-dealer (total assets)	Total number of BDs	Number of dual-registered BDs	Cumulative total assets	Cumulative number of customer accounts
>$50 billion	15	10	$2,647 bil.	40,964,945
$1 billion to $50 billion	70	19	923 bil.	77,667,615
$500 million to $1 billion	23	7	16 bil.	4,547,574
$100 million to $500 million	93	25	20 bil.	1,957,981
$10 million to $100 million	372	94	14 bil.	2,566,203
$1 million to $10 million	815	139	3 bil.	216,158
<$1 million	1,469	66	$.4 bil.	5,588
Total	2,857	360	$3,624 bil.	127,926,064

broker-dealer in Section 7A of Schedule D of Form ADV, including 1,916 SEC-registered investment advisers that report an affiliate that is a registered broker-dealer. Approximately 75% of total assets under management of investment advisers are managed by these 2,478 investment advisers.

459 We examined Form BD filings to identify broker-dealers reporting non-securities business. For the 546 broker-dealers reporting such business, staff analyzed the narrative descriptions of these businesses on Form BD, and identified the most common types of businesses: Insurance (208), management/financial/other consulting (101), advisory/retirement planning (80), mergers & acquisitions (71), foreign exchange/swaps/other derivatives (31), real estate/property management (31), tax services (15), and other (141). Note that a broker-dealer may have more than one line of non-securities business.

460 The value of customer accounts is not available from FOCUS data for broker-dealers. Therefore, to obtain estimates of firm size for broker-dealers, we rely on the value of broker-dealers total assets as obtained from FOCUS reports. Retail sales activity is identified from Form BR, which categorizes retail activity broadly (by marking the ''sales'' box) or narrowly (by marking the ''retail'' or ''institutional'' boxes as types of sales activity). We use the broad definition of sales as we preliminarily believe that many firms will just mark ''sales'' if they have both retail and institutional activity. However, we note that this may capture some broker-dealers that do not have retail activity, although we are unable to estimate that frequency. We request comment on whether firms that intermediate both retail and institutional customer activity generally market only ''sales'' on Form BR.

461 Total assets and customer accounts for broker-dealers that serve retail customers also include institutional accounts. Data available from Form BD and FOCUS data is not sufficiently granular to identify the percentage of retail and institutional accounts at firms.

462 Of the 36 dual registrants in the group of retail broker-dealers with total assets in excess of $500 million, total assets for these dual registrants are $2.19 trillion (60%) of aggregate retail broker-dealer assets. Of the remaining 72 retail broker-dealers, 67 have affiliated investment advisers.

463 The data is obtained from FOCUS filings as of December 2017. Note that there may be a double-counting of customer accounts among in particular the larger broker-dealers as they may report introducing broker-dealer accounts as well in their role as clearing broker-dealers.

464 In addition to the approximately 130 million individual accounts at broker-dealers, there are approximately 293,000 omnibus accounts (0.2% of total accounts at broker-dealers), across all 3,841 broker-dealers, of which approximately 99% are held at broker-dealers with greater than $1 billion in total assets. *See also supra* note 455. Omnibus accounts reported in FOCUS data are the accounts of non-carrying broker-dealers with carrying broker-dealers. These accounts may have securities of multiple customers (of the non-carrying firm), or securities that are proprietary assets of the non-carrying broker-dealer. We are unaware from the data available to determine how many customer accounts non-carrying broker-dealers may have. The data does not allow the Commission to parse the total assets in those accounts to determine to whom such assets belong. Therefore, our estimate may be underinclusive of all customer accounts held at broker-dealers.

465 Customer Accounts includes both broker-dealer and investment adviser accounts for dual registrants.

Table 2 reports information on brokerage commissions,[466] fees, and selling concessions from the fourth quarter of 2017 for all broker-dealers, including dual registrants.[467] On average, broker-dealers, including those that are dually registered as investment advisers, earn about $2.1 million per quarter in revenue from commissions and more than double that amount in fees,[468] although the Commission notes that fees encompass a variety of fees, not just those related to advisory services.[469] The level of revenues earned from broker-dealers for commissions and fees increases with broker-dealer size, but also tends to be more heavily weighted towards commissions for broker-dealers with less than $10 million in assets and is weighted more heavily towards fees for broker-dealers with assets in excess of $10 million. For example, for the 102 broker-dealers with assets between $1 billion and $50 billion, average revenues from commissions are $25 million, while average revenues from fees are approximately $91 million.[470]

In addition to revenue generated from commissions and fees, broker-dealers may also receive revenues from other sources, including margin interest, underwriting, research services, and third-party selling concessions, such as from sales of investment company (''IC'') shares. As shown in Table 2, Panel A, these selling concessions are generally a smaller fraction of broker-dealer revenues than either commissions or fees, except for broker-dealers with total assets between $10 million and $100 million. For these broker-dealers, revenue from third-party selling concessions is the largest category of revenues and constitutes approximately 44% of total revenues earned by these firms.

Table 2, Panel B, below provides aggregate revenues by revenue type (commissions, fees, or selling concessions) for broker-dealers delineated by whether the broker-dealer is also a dual registrant. Broker-dealers dually registered as investment advisers have a significantly larger fraction of their revenues from fees compared to commissions or selling concessions, whereas broker-dealers that are not dually registered generated approximately 43% of their advice-related revenues as commissions and only 32% of their advice-related revenues from fees, although we lack granularity to determine whether advisory services, in addition to supervision and administrative services, contribute to fees at standalone broker-dealers.

TABLE 2—PANEL A: AVERAGE BROKER-DEALER REVENUES FROM REVENUE GENERATING ACTIVITIES [471]

Size of broker-dealer in total assets	N	Commissions	Fees [472]	Sales of IC shares
>$50 billion	16	$176,193,599	$365,014,954	$20,493,769
$1 billion–$50 billion	102	25,109,619	91,966,559	18,808,687
$500 million–$1 billion	38	6,322,803	11,312,112	6,724,401
$100 million–$500 million	118	7,698,889	11,338,175	4,536,407
$10 million–$100 million	483	1,801,079	2,811,290	3,653,475
$1 million–$10 million	1,035	633,720	372,757	217,444
<$1 million	2,049	66,503	38,618	26,270
Average of All Broker-Dealers	3,841	2,132,544	4,897,521	1,322,759

TABLE 2—PANEL B: AGGREGATE TOTAL REVENUES FROM REVENUE GENERATING ACTIVITIES FOR BROKER-DEALERS BASED ON DUAL REGISTRANT STATUS

Broker-dealer type	N	Commissions	Fees [473]	Sales of IC shares
Dual Registered as IAs	366	$4.27 bil.	$15.88 bil.	$2.8 bil.
Standalone Registered BDs	3,475	3.92 bil.	2.93 bil.	2.28 bil.
All	3,841	8.19 bil.	18.81 bil.	5.08 bil.

[466] FOCUS data does not provide mark-ups or mark-downs as a separate revenue category and they are not included as part of the brokerage commission revenue.

[467] Source: FOCUS data.

[468] Fees, as detailed in the FOCUS data, include fees for account supervision, investment advisory and administrative services. Beyond the broad classifications of fee types included in fee revenue, we are unable to determine whether fees such as 12b–1 fees, sub-accounting, or other such service fees are included. The data covers both broker-dealers and dually-registered firms. FINRA's Supplemental Statement of Income, Line 13975 (Account Supervision and Investment Advisory Services) denotes that fees earned for account supervision are those fees charged by the firm for providing investment advisory services where there is no fee charged for trade execution. Investment Advisory Services generally encompass investment advisory work and execution of client transactions, such as wrap arrangements. These fees also include fees charged by broker-dealers that are also registered with the Commodity Futures Trading Commission (''CFTC''), but do not include fees earned from affiliated entities (Item A of question 9 under Revenue in the Supplemental Statement of Income).

[469] With respect to the FOCUS data, additional granularity of what services comprise ''advisory services'' is not available.

[470] A rough estimate of total fees in this size category would be 102 broker-dealers with assets between $1 billion and $50 billion multiplied by the average fee revenue of $91 million, or $9.381 billion in total fees. Divided by the number of customer accounts in this size category (81,611,933), the average account would be charged approximately $115 in fees per quarter, or $460 per year.

[471] The data obtained from December 2017 FOCUS reports and averaged across size groups.

[472] Fees, as detailed in the FOCUS data, include fees for account supervision, investment advisory and administrative services. The data covers both broker-dealers and dually-registered firms.

[473] *See id.*

i. Disclosures for Broker-Dealers

Broker-dealers register with and report information to the Commission, the SROs, and other jurisdictions through Form BD. Form BD requires information about the background of the applicant, its principals, controlling persons, and employees, as well as information about the type of business the broker-dealer proposes to engage in and all control affiliates engaged in the securities or investment advisory business.[474] Broker-dealers report whether a broker-dealer or any of its control affiliates have been subject to criminal prosecutions, regulatory actions, or civil actions in connection with any investment-related activity, as well as certain financial matters.[475] Once a broker-dealer is registered, it must keep its Form BD current by amending it promptly when the information is or becomes inaccurate for any reason.[476] In addition, firms report similar information and additional information to FINRA pursuant to FINRA Rule 4530.[477] The current Paperwork Reduction Act estimate for the total industry-wide annual filing burden to comply with rule 15b1–1 and file Form BD is approximately 4,999 hours, with an estimated internal cost of compliance associated with those burden hours for all broker-dealers of $1,394,721.

A significant amount of information concerning broker-dealers and their associated natural persons, including information from Form BD, Form BDW, and Forms U4, U5, and U6, is publicly available through FINRA's BrokerCheck system. This information includes violations of and claims of violations of the securities and other financial laws by broker-dealers and their financial professionals; criminal or civil litigation, regulatory actions, arbitration, or customer complaints against broker-dealers and their financial professionals; and the employment history and licensing information of financial professionals associated with broker-dealers, among other things.[478]

Broker-dealers are subject to other disclosure requirements under the federal securities laws and SRO rules. For instance, under existing antifraud provisions of the Exchange Act, a broker-dealer has a duty to disclose material information to its customers conditional on the scope of the relationship with the customer.[479] Disclosure has also been a feature of other regulatory efforts related to financial services, including those of DOL and certain FINRA rules.[480]

b. Investment Advisers

Other parties that would be affected by the proposed rules and proposed Form CRS are SEC-registered investment advisers.[481] This section first discusses SEC-registered investment advisers, followed by a discussion of state-registered investment advisers.

As of December 2017, there are approximately 12,700 investment advisers registered with the Commission. The majority of SEC-registered investment advisers report that they provide portfolio management services for individuals and small businesses.[482]

Of all SEC-registered investment advisers, 366 identified themselves as dually registered broker-dealers.[483] Further, 2,478 investment advisers (20%) reported an affiliate that is a broker-dealer, including 1,916 investment advisers (15%) that reported an SEC-registered broker-dealer affiliate.[484] As shown in Panel A of Table 3 below, in aggregate, investment advisers have over $72 trillion in assets under management (''AUM''). A substantial percentage of AUM at investment advisers is held by institutional clients, such as investment companies, pooled investment vehicles, and pension or profit sharing plans; therefore, although the dollar value of AUM for investment advisers and of customer assets in broker-dealer accounts is comparable, the total number of accounts for investment advisers is only 27% of the number of customer accounts for broker-dealers.

Based on staff analysis of Form ADV data, approximately 60% of investment advisers (7,600) have some portion of their business dedicated to retail investors, including both high net worth and non-high net worth individual clients, as shown in Panel B of Table 3.[485] In total, these firms have approximately $32 trillion of assets under management.[486] Approximately 6,600 registered investment advisers (52%) serve 29 million non-high net worth individual clients and have approximately $5.33 trillion in assets under management, while nearly 7,400 registered investment advisers (58%) serve approximately 4.8 million high net worth individual clients with $6.56 trillion in assets under management.[487]

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[474] *See generally* Form BD.

[475] *See* Item 11 and Disclosure Reporting Pages, Form BD.

[476] *See* Exchange Act rule 15b3–1(a).

[477] *See supra* Section II.B.7.

[478] FINRA Rule 8312 governs the information FINRA releases to the public via BrokerCheck. *See supra* note 280 and accompanying text.

[479] A broker-dealer also may be liable if it does not disclose ''material adverse facts of which it is aware''. *See, e.g., Chasins* v. *Smith, Barney & Co.,* 438 F.2d at 1172; *SEC* v. *Hasho,* 784 F. Supp. at 1110; Release 48758, *supra* note 243 (''When a securities dealer recommends stock to a customer, it is not only obligated to avoid affirmative misstatements, but also must disclose material adverse facts of which it is aware. That includes disclosure of ''adverse interests'' such as ''economic self-interest'' that could have influenced its recommendation.'') (citations omitted).

[480] *See, infra* Section IV.A.1.c; FINRA Notice 10–54, *supra* note 12. Generally, all registered broker-dealers that deal with the public must become members of FINRA, a registered national securities association, and may choose to become exchange members. *See* Exchange Act section 15(b)(8) and Exchange Act rule 15b9–1. FINRA is the sole national securities association registered with the SEC under section 15A of the Exchange Act. Accordingly, for purposes of discussing a broker-dealer's regulatory requirements when providing advice, we focus on FINRA's regulation, examination and enforcement with respect to member broker-dealers. FINRA disclosure rules include but are not limited FINRA rules 2210(d)(2) (communications with the public), 2260 (disclosures), 2230 (customer account statements and confirmations), and 2270 (day-trading risk disclosure statement).

[481] In addition to SEC-registered investment advisers, which are the focus of this section, the proposed rules and proposed Form CRS could also affect banks, trusts, insurance companies, and other providers of financial advice.

[482] Of the approximately 12,700 SEC-registered investment advisers, 7,979 (64%) report in Item 5.G.(2) of Form ADV that they provide portfolio management services for individuals and/or small businesses. In addition, there are approximately 17,800 state-registered investment advisers, of which 145 are also registered with the Commission. Approximately 13,800 state-registered investment advisers are retail facing (*see* Item 5.D of Form ADV).

[483] See *supra* note 457.

[484] Item 7.A.1 of Form ADV.

[485] We use the responses to Items 5.D.(a)(1), 5.D.(a)(3), 5.D.(b)(1), and 5.D.(b)(3) of Part 1A. If at least one of these responses was filled out as greater than 0, the firm is considered as providing business to retail investors. Form ADV Part 1A.

[486] The aggregate AUM reported for these investment advisers that have retail investors includes both retail AUM as well as any institutional AUM also held at these advisers.

[487] Estimates are based on IARD system data as of December 31, 2017. The AUM reported here is specifically that of those non-high net worth clients. Of the 7,600 investment advisers serving retail investors, 360 may also be dually registered as broker-dealers.

TABLE 3—PANEL A: REGISTERED INVESTMENT ADVISERS (RIAS) AS OF DECEMBER 2017

[Cumulative RIA assets under management (AUM) and accounts]

Size of investment adviser (AUM)	Number of RIAs	Number of dual-registered RIAs	Cumulative AUM	Cumulative number of accounts
>$50 billion	246	15	$48,221 bil.	17,392,968
$1 billion to $50 billion	3,238	115	21,766 bil.	11,560,805
$500 million to $1 billion	1,554	53	1,090 bil.	2,678,084
$100 million to $500 million	5,568	129	1,303 bil.	3,942,639
$10 million to $100 million	1,103	24	59 bil.	198,659
$1 million to $10 million	172	2	1 bil.	5,852
<$1 million	778	28	.02 bil.	31,291
Total	12,659	366	72,439 bil.	35,810,298

TABLE 3—PANEL B: RETAIL REGISTERED INVESTMENT ADVISERS (RIAS) AS OF DECEMBER 2017

[Cumulative RIA assets under management (AUM) and accounts]

Size of investment adviser (AUM)	Number of RIAs	Number of dual-registered RIAs	Cumulative AUM	Cumulative number of accounts
>$50 billion	106	15	$22,788 bil.	16,638,548
$1 billion to $50 billion	1,427	114	8,472 bil.	10,822,275
$500 million to $1 billion	934	52	652 bil.	2,602,220
$100 million to $500 million	4,114	126	917 bil.	3,814,900
$10 million to $100 million	711	24	40 bil.	231,663
$1 million to $10 million	98	1	.4 bil.	5,804
<$1 million	198	29	.02 bil.	31,271
Total	7,588	361	32,870 bil.	34,146,681

As an alternative to registering with the Commission, smaller investment advisers could register with state regulators.[488] As of December 2017, there are 17,635 state registered investment advisers,[489] of which 145 are also registered with the Commission. Of the state-registered investment advisers, 236 are dually registered as broker-dealers, while 5% (920) report a broker-dealer affiliate. In aggregate, state-registered investment advisers have approximately $341 billion in AUM. Eighty-two percent of state-registered investment advisers report that they provide portfolio management services for individuals and small businesses, compared to just 64% for SEC-registered investment advisers.

Approximately 77% of state-registered investment advisers (13,470) have some portion of their business dedicated to retail investors,[490] and in aggregate, these firms have approximately $308 billion in AUM.[491] Approximately 12,700 (72%) state-registered advisers serve 616,000 non-high net worth retail clients and have approximately $125 billion in AUM, while over 11,000 (63%) state-registered advisers serve approximately 194,000 high net worth retail clients with $138 billion in AUM.[492]

Table 4 details the compensation structures employed by approximately 12,700 investment advisers. Approximately 95% are compensated through a fee-based arrangement, where a percentage of assets under management are remitted to the investment adviser from the investor for advisory services. As shown in the table below, most investment advisers rely on a combination of different compensation types, beyond fee-based compensation, including fixed fees, hourly charges, and performance based fees. Less than 4% of investment advisers charge commissions [493] to their investors.

[488] Pursuant to the Dodd-Frank Act, Item 2.A. of Part 1A of Form ADV requires an investment adviser to register with the SEC if it (i) is a large adviser that has $100 million or more of regulatory assets under management (or $90 million or more if an adviser is filing its most recent annual updating amendment and is already registered with the SEC); (ii) is a mid-sized adviser that does not meet the criteria for state registration or is not subject to examination; (iii) meets the requirements for one or more of the revised exemptive rules under section 203A discussed below; (iv) is an adviser (or subadviser) to a registered investment company; (v) is an adviser to a business development company and has at least $25 million of regulatory assets under management; or (vi) received an order permitting the adviser to register with the Commission. Although the statutory threshold is $100 million, the SEC raised the threshold to $110 million for those investment advisers that do not already file with the SEC.

[489] There are 79 investment advisers with latest reported Regulatory Assets Under Management in excess of $110 million but are not listed as registered with the SEC. For the purposes of this rulemaking, these are considered erroneous submissions.

[490] We use the responses to Items 5.D.(a)(1), 5.D.(a)(3), 5.D.(b)(1), and 5.D.(b)(3) of Part 1A. If at least one of these responses was filled out as greater than 0, the firm is considered as providing business to retail investors. Form ADV Part 1A.

[491] The aggregate AUM reported for these investment advisers that have retail investors includes both retail AUM as well as any institutional AUM also held at these advisers.

[492] Estimates are based on IARD system data as of December 31, 2017. The AUM reported here is specifically that of those non-high net worth investors. Of the 13,471 investment advisers serving retail investors, 144 may also be dually registered as broker-dealers.

[493] Some investment advisers report on Item 5.E. of Form ADV that they receive ''commissions.'' As a form of deferred sales load, all payments of ongoing sales charges to intermediaries would constitute transaction-related compensation. Intermediaries receiving those payments should consider whether they need to register as broker-dealers under section 15 of the Exchange Act.

TABLE 4—REGISTERED INVESTMENT ADVISERS COMPENSATION BY TYPE

Compensation type	Yes	No
A percentage of assets under management	12,041	617
Hourly charges	3,670	8,988
Subscription fees (for a newsletter or periodical)	119	12,539
Fixed fees (other than subscription fees)	5,406	7,252
Commissions	490	12,168
Performance-based fees	4,780	7,878
Other	1,846	10,812

As discussed above, many investment advisers participate in wrap fee programs. As of December 31, 2017, more than 5% of the SEC-registered investment advisers sponsor a wrap fee program and more than 9% act as a portfolio manager for one or more wrap fee programs.[494] From the data available, we are unable to determine how many advisers provide advice about investing in wrap fee programs, because advisers providing such advice may be neither sponsors nor portfolio managers.

ii. Disclosures for Investment Advisers

As fiduciaries, investment advisers have a duty to provide full and fair disclosure of material facts and are subject to express disclosure requirements in Form ADV.[495] Consistent with this duty and those requirements, investment advisers file Form ADV to register with the Commission or state securities authorities, as applicable, and provide an annual update to the form.[496] Part 1 of Form ADV provides information to regulators, and made available to clients, prospective clients, and the public, about the registrants' ownership, investors, and business practices. Advisers also prepare a Form ADV Part 2A narrative brochure that contains information about the investment adviser's business practices, fees, conflicts of interest, and disciplinary information,[497] in addition to a Part 2B brochure supplement that includes information about the specific individuals, acting on behalf of the investment adviser, who actually provide investment advice and interact with the client.[498] Currently, the Part 2A brochure is the primary client-facing disclosure document,[499] however, Parts 1 and 2A are both made publicly available by the Commission through IAPD,[500] and advisers are generally required to deliver Part 2A and Part 2B to their clients. The current Paperwork Reduction Act estimate of the average annual cost and hour burden for investment advisers to complete, amend, and file all parts of Form ADV are $6,051 and 23.77 hours.[501]

c. Disclosure Obligations for Broker-Dealers and Investment Advisers Under DOL Rules and Exemptions

As noted, firms and financial professionals providing services to customers in retirement accounts, including workplace retirement plans and IRAs, are subject to certain disclosure obligations under rules and exemptions issued by the DOL under ERISA and the prohibited transaction provisions of the Code.[502] For example, DOL regulations under a statutory exemption for investment advice services provided to plan participants and IRAs requires firms and financial professionals to disclose information about the services that they will provide and their fees and other compensation, and to acknowledge that the adviser is acting as a fiduciary.[503]

More recently, the DOL's BIC Exemption would require that firms seeking to rely on the exemption to receive commissions and other fees in connection with making investment recommendations to IRAs and participants of ERISA-covered plans (including advice relating to rollovers from plans or between account types)[504]

[494] A wrap fee program sponsor is as a firm that sponsors, organizes, or administers the program or selects, or provides advice to clients regarding the selection of, other investment advisers in the program. *See* General Instructions to Form ADV.

[495] *See SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. at 194; *see also* Brochure Adopting Release, *supra* note 157. *See also* 913 Study, *supra* note 3, at n.92. For example, if an adviser selects or recommends other advisers to investors, it must disclose any compensation arrangements or other business relationships between the advisory firms, along with the conflicts created, and explain how it addresses these conflicts. *See* Item 10 of Form ADV Part 2A. *See also* 913 Study, *supra* note 3, at n.93. Other potential conflicts of interest include acting as a principal in transactions with investors and compensation received thereof; incentives provided by third parties to sell their services and products; and agency cross-trades, where the advisers is also a broker-dealer and executes a client's order by crossing the orders with those of non-advisory clients. *See* Interpretation of Section 206(3) of the Investment Advisers Act of 1940, Investment Advisers Act Release No. 1732 (Jul. 20, 1998), at n.3.

[496] *See* Advisers Act rules 203–1 and 204–1. Part 1A (1B) of Form ADV is the registration application for the Commission (and state securities authorities). Part 2 of Form ADV consists of a narrative ''brochure'' about the adviser and ''brochure supplements'' about certain advisory personnel on whom clients may rely for investment advice. *See* Brochure Adopting Release, *supra* note 157.

[497] Part 2A of Form ADV contains 18 mandatory disclosure items about the advisory firm, including information about an adviser's: (1) Range of fees; (2) methods of analysis; (3) investment strategies and risk of loss; (4) brokerage, including trade aggregation polices and directed brokerage practices, as well as the use of soft dollars; (5) review of accounts; (6) client referrals and other compensation; (7) disciplinary history; and (8) financial information, among other things. Much of the disclosure in Part 2A addresses an investment adviser's conflicts of interest with its investors, and is disclosure that the adviser, as a fiduciary, must make to investors in some manner regardless of the form requirements. *See* Brochure Adopting Release, *supra* note 157.

[498] Part 2B, or the ''brochure supplement,'' includes information about certain advisory personnel that provide retail client investment advice, and contains educational background, disciplinary history, and the adviser's supervision of the advisory activities of its personnel. *See* Instruction 5 of General Instructions for Form ADV. Registrants are not required to file Part 2B (brochure supplement) electronically, but must preserve a copy of the supplement(s) and make them available upon request.

[499] *See* Brochure Adopting Release, *supra* note 157.

[500] *See* Investment Adviser Public Disclosure, *available at https://adviserinfo.sec.gov/.*

[501] *See infra* Section V.A.2.

[502] See *supra* note 11.

[503] See 29 CFR 2550.408g–1(b)(7). In general, firms and financial professionals who receive commissions or other transaction-related compensation in connection with providing certain fiduciary investment recommendations relating to the assets of ERISA-covered workplace retirement plans and IRAs could violate provisions under the Code prohibiting fiduciaries from engaging in self-dealing and receiving compensation from third parties in connection with investments by these plans and IRA (and, with respect to such plans, substantially similar prohibited transaction rules that apply under ERISA to transactions involving ERISA plans but not IRAs). To receive such compensation, firms have historically complied with one or more prohibited transaction exemptions (''PTEs'') issued by the DOL over time, which generally required (among other conditions) disclosures about, *e.g.,* direct and indirect compensation received in connection with a recommended transactions. *See* Definition of the Term ''Fiduciary;'' Conflict of Interest Rule—Retirement Investment Advice, 81 FR 20945, 20991–92 (Apr. 8, 2016) (to be codified at 20 C.F.R. pts. 2509, 2510 and 2550) (''DOL Fiduciary Rule Adopting Release'') (describing action to adopt new and amended PTEs and revoke certain PTEs applicable to investment advice services).

[504] *See* Best Interest Contract Exemption, 81 FR 21002, 21006–7 (Apr. 8, 2016) (''BIC Exemption

generally must (among other conditions) provide disclosure about the services to be performed (including monitoring of recommendations, offering proprietary products and limiting recommendations) and how the investor will pay for services, material conflicts of interest (including third party compensation to the firm, affiliates and financial professionals), and must also make certain ongoing disclosures on a public website.[505] The DOL adopted the BIC Exemption in connection with the amendment of its regulation defining ''investment advice,'' which had the effect of expanding the circumstances under which broker-dealers and investment advisers may be fiduciaries for purposes of the prohibited transaction provisions under ERISA and the Code (the ''DOL Fiduciary Rule'').[506] Although a decision of the Court of Appeals for the Fifth Circuit recently vacated the DOL Fiduciary Rule,[507] we understand that many firms already have taken steps to implement conditions under the BIC Exemption.[508]

The Commission does not currently have data on the number of firms that are subject to disclosure obligations under applicable DOL rules and exemptions.[509] However, because we understand that most broker-dealers expected that they would be required to comply with the BIC Exemption to continue to provide services to retail investors in IRAs and participant-directed workplace retirement plans,[510] the Commission can broadly estimate the maximum number of broker-dealers that could be subject to disclosure obligations under DOL rules and exemption including the BIC Exemption from the number of broker-dealers that have retail investor accounts. Approximately 74.4% (2,857) of registered broker-dealers report sales to retail customers.[511] Similarly, approximately 60% (7,600) of investment advisers serve high net worth and non-high net worth individual clients. The Commission believes that this number likely overestimates those broker-dealers and investment advisers that provide retirement account services. Therefore, these 2,850 broker-dealers and 7,600 investment advisers that provide retail services represent an upper bound of the number of broker-dealers and investment advisers that would likely be subject to compliance with disclosure obligations under DOL rules and exemptions and may have taken steps to comply with the contract, disclosure and other conditions under the DOL's BIC Exemption.[512]

d. Trends in the Relative Numbers of Providers of Financial Services

Over time, the relative number of broker-dealers and investment advisers has changed. Figure 1 presented below shows the time series trend of growth in broker-dealers and investment advisers between 2005 and 2017. Over the last 13 years, the number of broker-dealers has declined from over 6,000 in 2005 to less than 4,000 in 2017, while the number of investment advisers has increased from approximately 9,000 in 2005 to over 12,000 in 2017. This change in the relative numbers of broker-dealers and investment advisers over time likely affects the competition for advice, and potentially alters the choices available to investors on how to receive or pay for such advice, the nature of the advice, and the attendant conflicts of interest.

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Release'') Best Interest Contract Exemption; Correction (Prohibited Transaction Exemption 2016–01), 81 FR 44773 (July 11, 2016) (''Corrected BIC Exemption''), *as amended* 18-Month Extension of Transition Period and Delay of Applicability Dates; Best Interest Contract Exemption (PTE 2016–01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (PTE 2016–02); Prohibited Transaction Exemption 84–24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters (PTE 84–24), 82 FR 56545 (Nov. 29, 2017). Depending on how they are compensated, investment advisers receiving a level fee may not be subject to the full set of contract, disclosure and other conditions of the BIC Exemption.

[505] *See* Corrected BIC Exemption, *supra* note 504, at sections II and III. Ongoing website disclosure would include information about certain material conflicts of interest and third party payments, a schedule of typical fees and service charges, a description of the compensation and incentive arrangements for individual financial professionals, and a written description of the financial institution's policies and procedures. *Id.,* at section III. In the case of recommendations provided to an IRA, the firm also would be required to enter into a written contract with the IRA owner that includes an acknowledgement of fiduciary status and an enforceable promise to adhere to certain ''impartial conduct standards'' (including a best interest standard of conduct). *Id.,* at section II(a).

[506] *See* DOL Fiduciary Rule Adopting Release, *supra* note 503.

[507] *See Chamber of Commerce of the U.S.A., e. al.* v. *U.S. Dep't of Labor, et. al.,* No. 17–10238 (5th Cir. Mar 15, 2018).

[508] *See* SIFMA and Deloitte, *The DOL Fiduciary Rule: A study on how financial institutions have responded and the resulting impacts on retirement investors* (Aug. 9, 2017), *available at https://www.sifma.org/wp-content/uploads/2017/08/;Deloitte-White-Paper-on-the-DOL-Fiduciary-Rule-August-2017.pdf.*

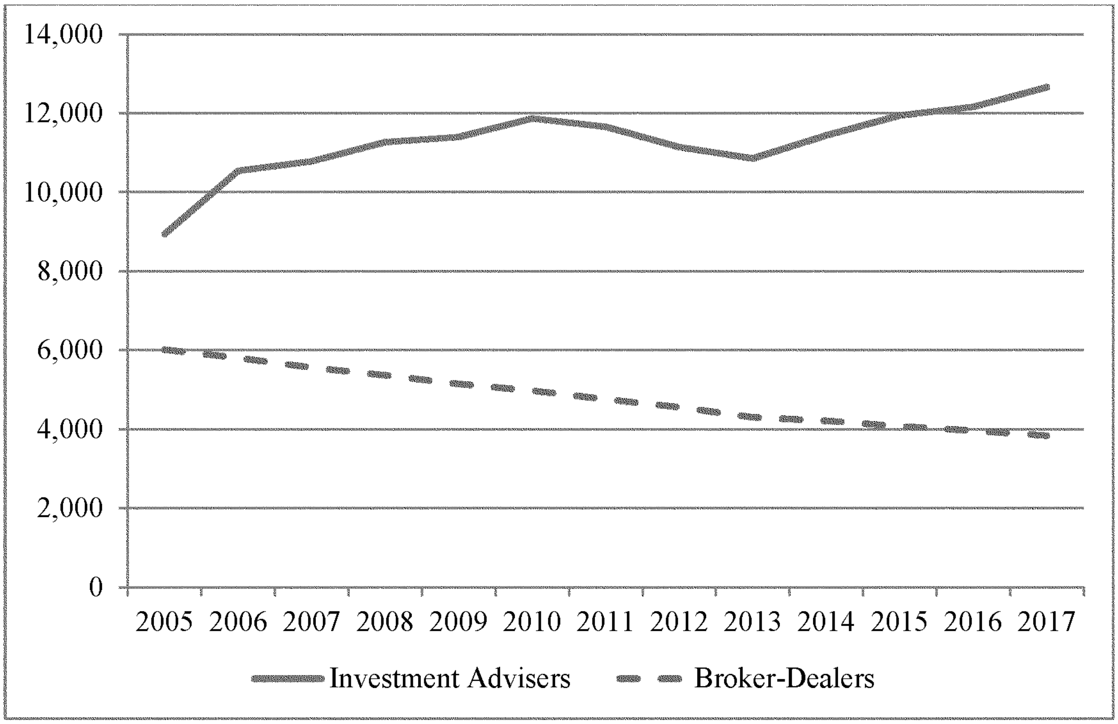
[509] In order to obtain this information, the Commission would need to know which financial firms have retirement-based accounts as part of their business model. Under the current reporting regime for both broker-dealers and investment advisers, they are not required to disclose whether (or what fraction) of their accounts are held by retail investors in retirement-based accounts.

[510] *See* BIC Exemption Release, *supra* note 504, at 21006–07 (DOL states that it ''anticipates that the [DOL Fiduciary Rule] will cover many investment professionals who did not previously consider themselves to be fiduciaries under ERISA or the Code.'').

[511] As of December 2017, 3,841 broker-dealers filed Form BD. Retail sales by broker-dealers were obtained from Form BD.

[512] The DOL's Regulatory Impact Analysis estimated that the numbers of broker-dealers and investment advisers (including state-registered investment advisers) that could be affected by their rule are approximately 2,500 and 17,500, respectively. *See* Regulatory Impact Analysis for Final Rule and Exemptions, *Definition Of The Term ''Fiduciary'' Conflicts Of Interest—Retirement Investment Advice* (Apr. 2016), at 215–229, *available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf.*

Figure 1: Time Series of the Number of Investment Advisers and Broker-Dealers (2005 – 2017)



Increases in the number of investment advisers and decreases in the number of broker-dealers could have occurred for a number of reasons, including anticipation of possible regulatory changes to the industry, other regulatory restrictions, technological innovation (*i.e.,* robo-advisers and online trading platforms), product proliferation (*e.g.,* index mutual funds and exchange-traded products), and industry consolidation driven by economic and market conditions, particularly among broker-dealers.[513] Commission staff has observed the transition by broker-dealers from traditional brokerage services to also providing investment advisory services (often under an investment adviser registration, whether federal or state), and many firms have been more focused on offering fee-based accounts than accounts that charge commissions.[514] Broker-dealers have indicated that the following factors have contributed to this migration: Provision of stability or increase in profitability,[515] perceived lower regulatory burden, and provisions of more services to retail customers.

Further, there has been a substantial increase in the number of retail clients at investment advisers, both high net worth clients and non-high net worth clients as shown in Figure 2. Although the number of non-high net worth retail customers of investment advisers dipped between 2010 and 2012, since 2012, more than 12 million new non-

[513] *See,* Hester Peirce, *Dwindling numbers in the financial industry,* Brookings Center on Markets and Regulation (May 15, 2017), *available at https://www.brookings.edu/research/dwindling-numbers-in-the-financial-industry/* (''Brookings Report'') which notes that ''SEC restrictions have increased by almost thirty percent [since 2000],'' and that regulations post-2010 were driven in large part by the Dodd-Frank Act, page 5. Further, the Brookings Report observation of increased regulatory restrictions on broker-dealers only reflects CFTC or SEC regulatory actions, but does not include regulation by FINRA, SROs, NFA, or the MSRB.

[514] The Brookings Report, *supra* note 513, also discusses the shift from broker-dealer to investment advisory business models for retail investors, in part due to the DOL Fiduciary Rule (page 7). *See also* the RAND Study, *supra* note 5, which documents a shift from transaction-based to fee-based accounts prior to recent regulatory changes. Declining transaction-based revenue due to declining commission rates and competition from discount brokerage firms has made fee-based products and services more attractive. Although discount brokerage firms generally provide execution-only services and do not compete directly in the advice market with full service broker-dealers and investment advisers, entry by discount brokers has contributed to lower commission rates throughout the broker-dealer industry. Further, fee-based activity generates a steady stream of revenue regardless of the customer trading activity, unlike commission-based accounts.

[515] Commission staff examined a sample of recent Form 10–K or Form 10–Q filings of large broker-dealers, many of which are dually registered as investment advisers, that have a large fraction of retail customer accounts to identify relevant broker-dealers. *See, e.g.,* Edward Jones 9/30/2017 Form 10–Q *available at https://www.sec.gov/Archives/edgar/data/815917/000156459017023050/ck0000815917-10q_20170929.htm*; Raymond James 9/30/2017 Form 10–K *available at https://www.sec.gov/Archives/edgar/data/720005/000072000517000089/rjf-20170930x10k.htm*; Stifle 12/31/2016 Form 10–K *available at https://www.sec.gov/Archives/edgar/data/720672/000156459017022758/sf-10q_20170930.htm*; Wells Fargo 9/30/2017 10–Q *available at https://www.sec.gov/Archives/edgar/data/72971/000007297117000466/wfc-09302017x10q.htm*; and Ameriprise 12/31/2016 Form 10–K *available at https://www.sec.gov/Archives/edgar/data/820027/;000082002717000007/ameriprisefinancial12312016.htm.* We note that discussions in Form 10–K and 10–Q filings of this sample of broker-dealers here may not be representative of other large broker-dealers or of small to mid-size broker-dealers. Some firms have reported record profits as a result of moving clients into fee-based accounts, and cite that it provides ''stability and high returns.'' *See* ''Morgan Stanley Wealth Management fees climb to all-time high,'' Bloomberg, Jan. 18, 2018, *available at https://www.bloomberg.com/news/articles/2018-01-18/morgan-stanley-wealth-management-fees-hit-record-on-stock-rally.* Morgan Stanley increased the percentage of client assets in fee-based accounts from 37% in 2013 to 44% in 2017, while decreasing the dependence on transaction-based revenues from 30% to 19% over the same time period (Morgan Stanley Strategic Update, (Jan. 18, 2018), *available at https://www.morganstanley.com/about-us-ir/shareholder/4q2017-strategic-update.pdf*). *See also* Beilfuss, Lisa & Brian Hershberg, *WSJ Wealth Adviser Briefing: The Reinvention of Morgan and Merrill, Adviser Profile,* The Wall Street Journal (Jan. 25, 2018), *available at https://blogs.wsj.com/moneybeat/2018/01/25/wsj-wealth-adviser-briefing-the-reinvention-of-morgan-and-merrill-adviser-profile/.*

high net worth retail clients have been added. With respect to assets under management, we observe a similar, albeit more pronounced pattern for non-high net worth retail clients as shown in Figure 3. For high net worth retail clients, there has been a pronounced increase in AUM since 2012, although AUM has leveled off since 2015.

Figure 2: Time Series of the Number of Retail Clients of Investment Advisers (2010 – 2017)

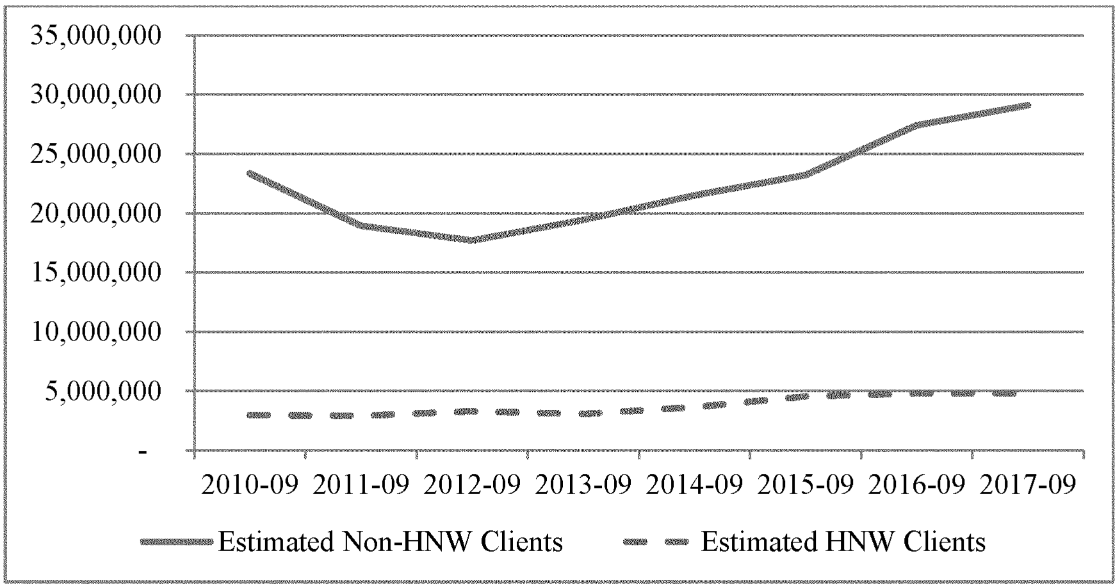
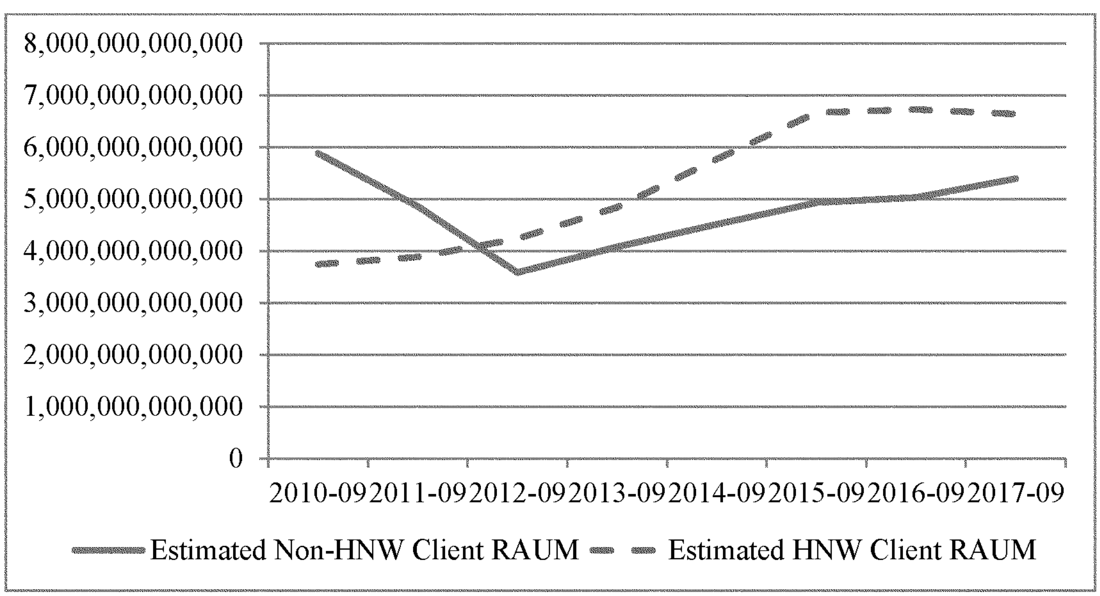


Figure 3: Time Series of the Retail Clients of Investment Advisers Assets under Management (2010 – 2017)



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e. Registered Representatives of Broker-Dealers, Investment Advisers and Dually Registered Firms

We estimate the number of associated natural persons of broker-dealers through data obtained from Form U4, which generally is filed for individuals who are engaged in the securities or investment banking business of a broker-dealer that is a member of a self-regulatory organization (“registered representatives'' or ''RR''s). [516] Similarly, we approximate the number of supervised persons of registered investment advisers through the number of registered investment adviser representatives (or ''registered IAR''s), who are supervised persons of investment advisers who meet the definition of investment adviser representatives in Advisers Act rule 203A–3 and are registered with one or more state securities authorities to solicit or communicate with clients.[517]

We estimate the number of registered representatives and registered IARs (together ''registered financial professionals'') at broker-dealers, investment advisers, and dual registrants by considering only the employees of those firms that have Series 6 or Series 7 licenses or are registered with a state as a broker-dealer agent or investment adviser representative.[518] We only consider employees at firms who have retail-facing business, as defined previously.[519] We observe in Table 5, that approximately 61% of registered financial professionals are employed by dually registered entities. The percentage varies by the size of the firm. For example, for firms with total assets between $1 billion and $50 billion, 72% of all registered financial professionals in that size category are employed by dually registered firms. Focusing on dually registered firms only, approximately 59.7% of total licensed representatives at these firms are dual-hatted, approximately 39.9% are only registered representatives; and less than one percent are only registered investment adviser representatives.

TABLE 5—TOTAL LICENSED REPRESENTATIVES AT BROKER-DEALERS, INVESTMENT ADVISERS, AND DUALLY REGISTERED FIRMS WITH RETAIL INVESTORS [520]

Size of firm (total assets for standalone BDs and dually registered firms; AUM for standalone IAs)	Total number of representatives	% of representatives in dually registered firms	% of representatives in standalone BD	% representatives in standalone IA
>$50 billion	82,668	75	8	18
$1 billion to $50 billion	150,662	72	10	18
$500 million to $1 billion	31,673	67	16	16
$100 million to $500 million	62,539	58	24	18
$10 million to $100 million	116,047	52	47	1
$1 million to $10 million	37,247	34	63	2
<$1 million	13,563	7	87	6
Total Licensed Representatives	494,399	61	27	12

In Table 6 below, we estimate the number of employees who are registered representatives, registered investment adviser representatives, or both (''dual-hatted representatives'').[521] Similar to Table 5, we calculate these numbers using Form U4 filings. Here, we also limit the sample to employees at firms that have retail-facing businesses as discussed previously.[522]

In Table 6, approximately 24% of registered employees at registered broker-dealers or investment advisers are dual-hatted representatives. However, this proportion varies significantly across size categories. For example, for firms with total assets between $1 billion and $50 billion,[523] approximately 36% of all registered employees are both registered representatives and investment adviser representatives. In contrast, for firms with total assets below $1 million, 15% of all employees are dual-hatted representatives.

[516] The number of associated natural persons of broker-dealers may be different from the number of registered representatives of broker-dealers, because clerical/ministerial employees of broker-dealers are associated persons, but are not required to register with the firm. Therefore, using the registered representative number does not include such persons. However, we do not have data on the number of associated natural persons and therefore are not able to provide an estimate of the number of associated natural persons. We believe that the number of registered representatives is an appropriate approximation because they are the individuals at broker-dealers that provide advice and services to customers.

[517] *See* Advisers Act rule 203A–3. However, we note that the data on numbers of registered IARs may undercount the number of supervised persons of investment advisers who provide investment advice to retail investors because not all supervised persons who provide investment advice to retail investors are required to register as IARs. For example, Commission rules exempt from IAR registration supervised persons who provide advice only to non-individual clients or to individuals that meet the definition of ''qualified client.'' As discussed above, the definition of retail investor for purposes of this proposed rulemaking would include qualified clients who are natural persons and trusts that represent natural persons. Proposed General Instruction 9.(e) to Form CRS. In addition, state securities authorities may impose different criteria for requiring registration as an investment adviser representative.

[518] We calculate these numbers based on Form U4 filings. Representatives of broker-dealers, investment advisers, and issuers of securities must file this form when applying to become registered in appropriate jurisdictions and with self-regulatory organizations. Firms and representatives have an obligation to amend and update information as changes occur. Using the examination information contained in the form, we consider an employee a financial professional if he has an approved, pending, or temporary registration status for either Series 6 or 7 (RR) or is registered as an investment adviser representative in any state or U.S. territory (IAR). We limit the firms to only those that do business with retail investors, and only to licenses specifically required to be licensed as an RR or IAR.

[519] *See supra* notes 460 and 485.

[520] The classification of firms as dually registered, standalone broker-dealers, and standalone investment advisers comes from Forms BD, FOCUS, and ADV as described earlier. The number of representatives at each firm is obtained from Form U4 filings. Note that all percentages in the table have been rounded to the nearest whole percentage point.

[521] We calculate these numbers based on Form U4 filings.

[522] *See supra* notes 460 and 485.

[523] Firm size is defined as total assets from the balance sheet (source: FOCUS reports) for broker-dealers and dual registrants and is assets under management for investment advisers (source: Form ADV).

TABLE 6—NUMBER OF EMPLOYEES AT RETAIL FACING FIRMS WHO ARE REGISTERED REPRESENTATIVES, INVESTMENT ADVISER REPRESENTATIVES, OR BOTH [524]

Size of firm (total assets for standalone BDs and dually registered firms; AUM for standalone IAs)	Total number of employees	Percentage of dual-hatted representatives	Percentage of RRs only	Percentages of IARs only
>$50 billion	216,655	18	17	1
$1 billion to $50 billion	292,663	36	11	3
$500 million to $1 billion	50,531	15	40	6
$100 million to $500 million	112,119	23	24	8
$10 million to $100 million	189,318	19	41	1
$1 million to $10 million	61,310	19	39	1
<$1 million	19,619	15	46	3
Total Employees at Retail Facing Firms	942,215	24	24	3

Approximately 88% of investment adviser representatives are dual-hatted as registered representatives. This percentage is relatively unchanged from 2010. According to information provided in a FINRA comment letter in connection with the 913 Study, 87.6% of registered investment adviser representatives were dually registered as registered representatives as of mid-October 2010.[525] In contrast, approximately 50% of registered representatives were dually registered as investment adviser representatives at the end of 2017.[526]

With respect to disclosure made about licensed individuals, broker-dealers and investment advisers must report certain criminal, regulatory, and civil actions and complaint information and information about certain financial matters in Forms U4 [527] and U5 [528] for their representatives. Self-regulatory organizations, regulators and jurisdictions report disclosure events on Form U6.[529] FINRA's BrokerCheck system discloses to the public certain information on registered representatives and investment adviser representatives such as principal place of business, business activities, owners, and criminal prosecutions, regulatory actions, and civil actions in connection with any investment-related activity.

f. Current Use of Names and Titles

Although many financial services firms are registered as broker-dealers, investment advisers, or are dually registered, both firms and financial professionals use a variety of terms to label both the firm and the professional. Approximately 103 broker-dealers that are not dually registered as investment advisers use the term ''adviser,'' ''advisor,'' or ''advisory'' as part of their current company name.[530] Of these broker-dealers, 16 reported at least one type of non-securities business. Approximately 39 percent of the 103 broker-dealers described above used a proper name coupled with the term ''advisor'' alone,[531] and an additional 31 percent used a proper name coupled with the term ''capital advisor.'' In addition to those terms, less than 10% of these broker-dealers use the terms ''financial advisor,'' ''investment advisor,'' or ''wealth advisor'' in their corporate name. The remainder of the broker-dealers (approximately 25 firms) use unique combinations of other words along with ''adviser,'' ''advisor'' or ''advisory.''

In addition to company names or professional titles, firms are likely to use labels or terms other than their formal company names to describe themselves in corporate descriptions, marketing material, or other communications with the public. To gauge the extent that registered broker-dealers and investment advisers use terms other than their registration status as descriptors, Commission staff conducted an analysis to evaluate the different terms that broker-dealer, investment adviser, and dually-registered firms use to describe themselves.[532] Commission staff reviewed firm websites to collect the terms that were used on the website to describe the firm.[533] Many firms provided multiple descriptions of their businesses.[534]

As shown below in Panel A of Table 7, over 50% of broker-dealers sampled use the term ''broker,'' ''dealer,'' ''broker-dealer,'' or ''brokerage'' to

[524] *See supra* notes 520–521. Note that all percentages in the table have been rounded to the nearest whole percentage point.

[525] Comment letter of FINRA to File Number 4–606; Obligations of Brokers, Dealers and Investment Advisers (Nov. 3, 2010), at 1, *available at https://www.sec.gov/comments/4-606/4606-2836.pdf*.

[526] In order to obtain the percentage of IARs that are dually registered as registered representatives of broker-dealers, we sum the representatives at dually-registered entities and those at investment advisers, across size categories to obtain the aggregate number of representatives in each of the two categories. We then divide the aggregate dually-registered representatives by the sum of the dually-registered representatives and the IARs at investment adviser-only firms. We perform a similar calculation to obtain the percentage of registered representatives of broker-dealers that are dually registered as IARs.

[527] Form U4 requires disclosure of registered representatives' and investment adviser representatives' criminal, regulatory, and civil actions similar to those reported on Form BD or Form ADV as well as certain customer-initiated complaints, arbitration, and civil litigation cases. *See generally* Form U4.

[528] Form U5 requires information about representatives' termination from their employers.

[529] *See* FINRA, Current Uniform Registration Forms for Electronic Filing in Web CRD, *available at http://www.finra.org/industry/web-crd/current-uniform-registration-forms-electronic-filing-web-crd.*

[530] Source: Form BD.

[531] *E.g.* ''ABC Advisor.''

[532] From the full sample of broker-dealers with retail investors (2,857) and investment advisers with retail investors (7,600), the Commission staff used a random number generator to select 20 firms in each of the size categories listed in Table 7, from which to construct a sample of firms for which staff hand-collected data on firm descriptions from firm website homepages and ''About'' pages, as available. When a size category contained less than 20 firms we sampled all firms in that category. Relative to the overall proportion of firms, we oversampled firms from the larger size categories because they employ a majority of all licensed representatives and are therefore the firms the average retail investor is most likely to come in contact with. Overall, 83 randomly selected standalone broker-dealers, 100 randomly selected investment advisers, and 91 randomly selected dual registrants based on the previously identified size categories (either total assets for broker-dealers and dual registrants or assets under management for investment advisers) provided the sample reviewed in the staff study. Further, the 917 Financial Literacy Study (*see supra* note 20) showed that a substantial percentage of retail investors use information obtained from firm websites in making the selection of their financial professional.

[533] *See* Table 7, Panel A for firm level identifiers for broker-dealers, Panel B for identifiers for investment advisers, and Panel C for dual registrants. Not all firms provided a description of their firm on their website, which we coded as ''N/A'' for not available.

[534] For purposes of our classification analysis, if ''ABC & Co.'' were to be a SEC-registered standalone broker-dealer and, on ABC's webpage in describing its business and operations, ABC refers to itself as a brokerage firm and a wealth manager, we would classify, ABC & Co. as using both ''brokerage'' and ''wealth manager'' as descriptors in our analysis.

describe their business, while less than 10% use ''financial advisor,'' ''wealth advisor,'' or ''investment advisor.'' Registered investment advisers (Panel B) are more likely to use the term ''investment advisor,'' ''wealth advisor,'' or ''financial advisor'' as a description of their business compared to broker-dealers (approximately 40%). Nearly 50% of the sampled standalone investment advisers use the term ''investment manager'' or ''wealth manager'' to describe their business model compared to less than 10% of broker-dealers that use these terms. Dually registered firms (Panel C) are much more diverse in their use of firm descriptions; approximately 40% use the term ''brokerage,'' ''broker-dealer,'' ''broker,'' or ''dealer,'' while nearly 30% use a firm description that contains the term ''adviser'' or ''advisor.''

TABLE 7—PANEL A: DESCRIPTION OF STANDALONE BROKER-DEALER FIRMS ON FIRM WEBSITES [535]

	Broker-dealer	Investment bank	Wealth/investment management	Advisory	Other	N/A
>$50 billion	2	2	0	2	0	0
$1 billion to $50 billion	15	6	0	0	0	1
$500 million to $1 billion	14	2	0	0	1	0
$100 million to $500 million	12	7	4	2	4	0
$10 million to $100 million	11	2	5	3	4	0
Total	54	19	9	7	9	1

TABLE 7—PANEL B: DESCRIPTION OF STANDALONE INVESTMENT ADVISER FIRMS ON FIRM WEBSITE [536]

	Broker-dealer	Investment bank	Wealth/investment management	Advisory	Other	N/A
>$50 billion	0	1	16	3	4	0
$1 billion to $50 billion	0	0	13	5	8	0
$500 million to $1 billion	0	0	10	13	9	0
$100 million to $500 million	0	0	6	7	9	3
$10 million to $100 million	2	0	2	10	7	1
Total	2	1	47	38	37	4

TABLE 7—PANEL C: DESCRIPTION OF DUALLY-REGISTERED FIRMS ON FIRM WEBSITE [537]

	Broker-dealer	Investment bank	Wealth/investment management	Advisory	Other	N/A
>$50 billion	5	8	2	4	1	0
$1 billion to $50 billion	7	8	5	6	9	0
$500 million to $1 billion	3	1	2	1	2	0
$100 million to $500 million	13	3	1	7	6	0
$10 million to $100 million	10	1	3	10	7	0
Total	38	21	13	28	25	0

Regarding the use of titles by individual financial professionals, a 2008 RAND Study,[538] found that households responding to the survey [539] reported a wide variety of titles were used by financial professionals with whom they worked. The RAND Study Table 6.3 (replicated below in Table 8) provides an overview of the most commonly used titles by services provided. As shown in the table, financial professionals providing brokerage services use a large variety of titles to describe their business and the services that they offer, including ''financial advisor,'' ''financial consultant,'' ''banker,'' and ''broker.'' Around 31% of professionals providing only brokerage services used titles containing the terms ''adviser'' or ''advisor.'' Professionals providing advisory services or both brokerage and advisory services similarly also use a wide variety of titles, but the proportion of professionals who use titles containing the terms ''adviser'' or ''advisor'' are somewhat larger at 35%. Note that the RAND Study did not distinguish financial professionals' use of tiles based on whether they were RRs or IARs, but rather by type of services provided.

[535] Broker-dealers are randomly drawn from Form BD data (as of Dec. 2017). The data on firm descriptions is hand collected from individual broker-dealer websites.

[536] Investment advisers are randomly drawn from Form ADV data (as of Dec. 2017). The data on firm descriptions is hand collected from individual investment adviser websites.

[537] Dual registrants are randomly drawn from Form BD data (as of Dec. 2017). The data on firm descriptions is hand collected from individual dually-registered firms' websites.

[538] RAND Study, *supra* note 5.

[539] Internet survey administered to members of the American Life Panel; 654 (out of 1000) households completed the survey.

TABLE 8—REPLICATION OF TABLE 6.3 OF THE RAND STUDY—PROFESSIONAL TITLES MOST COMMONLY REPORTED BY RESPONDENTS

Title	All individual professionals	Provide advisory services only	Provide brokerage services only	Provide both types of services
Advisor	11	1	1	9
Banker	21	2	8	11
Broker, stockbroker, or registered representative	38	0	8	30
CFP (Certified Financial Planner)	21	3	3	15
Financial adviser or financial advisor	78	7	11	60
Financial consultant	25	2	0	23
Financial planner	44	6	1	37
Investment adviser or investment advisor	22	3	3	16
President or vice president	20	0	2	18

2. Investor Account Statistics

Investors seek financial advice and services to achieve a number of different goals, such as saving for retirement or children's college education. As shown above in Figures 2 and 3, the number of retail investors and their assets under management associated with investment advisers has increased significantly, particularly since 2012. As of December 2016, nearly $24.2 trillion is invested in retirement accounts, of which $7.5 trillion is in IRAs.[540] In 2016, a total of 43.3 million U.S. households have either an IRA or a brokerage account, of which an estimated 20.2 million U.S. households have a brokerage account and 37.7 million households have an IRA (including 72% of households that also hold a brokerage account).[541] Table 9 below provides an overview of account ownership segmented by account type (*e.g.,* IRA, brokerage, or both) and investor income category based on the Survey of Consumer Finances (SCF).[542]

TABLE 9—OWNERSHIP BY ACCOUNT TYPE IN THE U.S. BY INCOME GROUP

[As reported by the 2016 SCF]

Income category	% Brokerage only	% IRA only	% Both brokerage and IRA
Bottom 25%	1.2	7.6	2.4
25%–50%	3.2	14.5	5.4
50%–75%	4.1	21.4	11.4
75%–90%	7.5	33.4	16.5
Top 10%	12.0	24.7	43.9
Average	4.4	18.3	11.6

One question in the SCF asks what sources of information households' financial decision-makers use when making decisions about savings and investments. Respondents can list up to fifteen possible sources from a preset list that includes ''Broker'' or ''Financial Planner'' as well as ''Banker,'' ''Lawyer,'' ''Accountant,'' and a list of non-professional sources.[543] Panel A of Table 10 below presents the breakdown of where households who have brokerage accounts seek advice about savings and investments. The table shows that of those respondents with brokerage accounts, 23% (4.7 million households) used advice services of broker-dealers for savings and investment decisions, while 49% (7.8 million households) took advice from a ''financial planner.'' Approximately 36% (7.2 million households) sought advice from other sources such as bankers, accountants, and lawyers. Almost 25% (5.0 million households) did not use advice from the above sources.

Panel B of Table 10 below presents the breakdown of advice received for households who have an IRA. 15% (5.7 million households) relied on advice services of their broker-dealers, 48% (18.3 million households) obtained advice from financial planners. Approximately 41% (15.5 million households) sought advice from bankers, accountants, or lawyers, while the 25% (9.5 million households) used no advice or sought advice from other sources.

[540] *See* ICI Research Perspective, *The Role of IRAs in U.S. Households' Saving for Retirement, 2016* (Jan. 2017), *available at https://www.ici.org/pdf/per23-01.pdf.*

[541] The data is obtained from the Federal Reserve System's 2016 Survey of Consumer Finances (''SCF''), a triennial survey of approximately 6,200 U.S. households and imputes weights to extrapolate the results to the entire U.S. population. As noted, some survey respondent households have both a brokerage and an IRA. Federal Reserve, *Survey of Consumer Finances* (2016), *available at https://www.federalreserve.gov/econres/scfindex.htm.* The SCF data does not directly examine the incidence of households that could use advisory accounts instead of brokerage accounts; however, some fraction of IRA accounts reported in the survey could be those held at investment advisers.

[542] *Id.* To the extent that investors have IRA accounts at banks that are not also registered as broker-dealers, our data may overestimate the numbers of IRA accounts held by retail investors that could be subject to this proposed rulemaking.

[543] The SCF specifically asks participants ''Do you get advice from a friend, relative, lawyer, accountant, banker, broker, or financial planner? Or do you do something else?'' (*see* Federal Reserve, *Codebook for 2016 Survey of Consumer Finances* (2016), *available at https://www.federalreserve.gov/econres/files/codebk2016.txt*). Other response choices presented by the survey included ''Calling Around,'' ''Magazines,'' ''Self,'' ''Past Experience,'' ''Telemarketer,'' and ''Insurance Agent,'' as well as other choices. Respondents could also choose ''Do Not Save/Invest.'' The SCF allows for multiple responses, so these categories are not mutually exclusive. However, we would note that the list of terms in the question did not specifically include ''investment adviser.''

TABLE 10—PANEL A: SOURCES OF ADVICE FOR HOUSEHOLDS WHO HAVE A BROKERAGE ACCOUNT IN THE U.S. BY INCOME GROUP [544]

Income category	% Taking advice from brokers	% Taking advice from financial planners	% Taking advice from lawyers, bankers, or accountants	% Taking no advice or from other sources
Bottom 25%	20.55	53.89	35.64	24.30
25%–50%	22.98	38.03	43.92	32.36
50%–75%	20.75	52.00	31.42	23.61
75%–90%	22.56	48.94	32.25	28.10
Top 10%	25.29	50.53	38.47	21.06
Average	23.02	49.02	35.99	24.94

TABLE 10—PANEL B: SOURCES OF ADVICE FOR HOUSEHOLDS WHO HAVE AN IRA IN THE U.S. BY INCOME GROUP [545]

Income category	% Taking advice from brokers	% Taking advice from financial planners	% Taking advice from bankers, accountants, or lawyers	% Taking no advice or from other sources
Bottom 25%	12.14	38.30	43.69	31.85
25%–50%	9.79	43.82	40.67	32.74
50%–75%	14.93	45.20	41.23	25.23
75%–90%	14.68	52.14	41.65	24.26
Top 10%	21.40	55.40	40.03	18.56
Average	15.25	48.45	41.17	25.28

3. Investor Perceptions About Broker-Dealers and Investment Advisers

Although many retail investors rely on broker-dealers and investment advisers to help them achieve financial goals, evidence indicates that many retail investors do not understand, or are confused by, among other items, the different standards of conduct applicable to broker-dealers and investment advisers, and are also confused and potentially misled by the titles used by firms and financial professionals. In the subsections below, we review in greater detail five aspects of investor perceptions with respect to: (1) How investors search for financial professionals and firms and; (2) the nature of the relationship with their financial professional (investment adviser or broker-dealer) and the meaning of company names and professional titles; (3) the structure and level of fees in the industry; (4) the existing conflicts of interest; (5) and the disciplinary history of the financial professional or firm.

g. How Investors Select Financial Firms or Professionals

A number of surveys show that retail investors predominantly find their current financial firm or financial professional from personal referrals by family, friends, or colleagues.[546] For instance, the RAND Study reported that 46% of survey respondents indicated that they located a financial professional from personal referral, although this percentage varied depending on the type of service provided (*e.g.,* only 35% of survey participants used personal referrals for brokerage services). After personal referrals, RAND survey participants ranked professional referrals (31%), print advertisements (4%), direct mailings (3%), online advertisements (2%), and television advertisements (1%), as their source of locating individual professionals. The RAND Study separately inquired about locating a financial firm, which yielded substantially different results from the selection of the financial professional.[547] Respondents reported selecting financial firm (of any type) based on: Referral from family or friends (29%), professional referral (18%), print advertisement (11%), online advertisements (8%), television advertisements (6%), direct mailings (2%), with a general ''other'' category (36%).

The 917 Financial Literacy Study provides similar responses, although it allowed survey respondents to identify multiple sources from which they obtained information that facilitated the selection of the current financial firm or financial professional.[548] In the 917 Financial Literacy Study,[549] 51% of survey participants received a referral from family, friends, or colleagues. Other sources of information or referrals came from: referral from another financial professional (23%), online search (14%), attendance at a financial professional-hosted investment seminar (13%), advertisement (*e.g.,* television or newspaper) (11.5%), other (8%), while approximately 4% did not know or could not remember how they selected their financial firm or financial professional. Twenty-five percent of survey respondents indicated that the ''name or reputation of the financial firm or financial professional'' affected the selection decision.

h. Nature of the Relationship

Comment letters as well as several studies provide us with information about retail investor confusion about the distinctions among different types firms and financial professionals. Several

[544] *Id.*

[545] *Id.*

[546] *See* RAND Study, *supra* at 5; 917 Financial Literacy Study, *supra* note 20.

[547] The Commission notes that only one-third of the survey respondents that responded to ''method to locate individual professionals'' also provided information regarding locating the financial firm.

[548] *See* 917 Financial Literacy Study, *supra* note 20.

[549] The data used in the 917 Financial Literacy Study comes from the Siegel & Gale *Investor Research Report* (Jul. 26, 2012), *available at https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part3.pdf,* at 249–250.

commenters in response to Chairman Clayton's recent Request for Comment highlighted investor confusion about whether financial services providers are subject to the fiduciary duty.[550] Particularly, some commenters tied investor confusion about the standard of care applicable to financial service providers to the names or titles of such firms and financial professionals.[551] Similarly, during the public comment process as part of the 913 Study, commenters indicated that retail investors did not understand or found confusing the distinctions between broker-dealers and investment advisers, for example, in terms of services provided and applicable standards of care.[552] Investor advocate groups submitted comments that reiterated the view that many market participants also believe that financial professionals should act in investors' best interests.[553] 913 Study commenters also expressed beliefs that certain titles used by firms and financial professionals are confusing to investors.[554]

Further findings of investor confusion about the roles and titles of financial professionals comes from studies conducted by Siegel & Gale[555] in 2004, RAND[556] in 2008 and CFA in 2010.[557] The Siegel & Gale Study found that focus group participants did not understand that the roles and legal obligations of broker-dealers differed from investment advisers, and were further confused by different labels or titles used by advice providers (*e.g.,* financial planner, financial advisor, financial consultant, broker-dealer, or investment adviser). More specifically, participants in the Siegel & Gale Study focus groups believed that brokers executed trades and were focused on ''near-term'' advice, while financial advisors and consultants provided many of the same services as brokers, but also provided a greater scope of long-term planning advice (*e.g.,* portfolio allocation). ''Investment adviser,'' on the other hand, was a term unfamiliar to many participants, but financial professionals using this label were perceived to provide similar services to financial advisors and financial consultants. Financial planners were viewed to provide services related to insurance and estate planning in addition to investment advice, and encompassed long-term financial planning including college, retirement, and other long-term savings and investment goals. The Siegel & Gale Study focus group participants assumed that financial advisors/consultants, investment advisers, and financial planners provided planning services, while brokers, financial advisors/consultants, and investment advisers provided trade execution services.[558] Further, the focus group participants generally did not understand certain legal terms, such as ''fiduciary.''

Similarly, the RAND Study generally concluded that investors did not understand the differences between broker-dealers and investment advisers and that common job titles contributed to investor confusion.[559] Further, participants responded similarly that investment advisers and brokers are required to act in the client's best interest. Similar to the Siegel and Gale Study, focus group participants did not understand the term fiduciary, or how the fiduciary standard differed from suitability. In addition, the RAND Study noted that the confusion about titles, services, legal obligations, and compensation persisted even after a fact sheet on broker-dealers and investment advisers was provided to participants.[560]

Similar to the Siegel and Gale Study and the RAND Study, the CFA Survey concluded that investors do not understand differences between broker-dealers and investment advisers, or the standards of conduct that apply to advice or recommendations made by these firms. For example, approximately 34% of investors surveyed believed that ''offering advice'' was a primary service of broker-dealers.[561] With respect to conduct-related questions, 91% of those surveyed believed that broker-dealers and investment advisers should follow the same investor protection rules if providing the same sort of advisory services, while 85% believed that the person providing advice should put the retail customer's interest ahead of theirs and should disclose fees and commissions earned or any conflicts of interest that could affect the advice provided. More than two-thirds believed that a fiduciary duty is owed to customers by broker-dealers, suggesting a degree of investor confusion.[562]

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550 *See, e.g.,* CFA 2017 Letter; PIABA 2017 Letter; IAA 2017 Letter; Pefin 2017 Letter.

551 *See* Chamber 2017 Letter, at 10; Committee for the Fiduciary Standard 2017 Letter, at 3; Pefin 2017 Letter, at 9.

552 *See* 913 Study, *supra* note 3, at section III.A.

553 *Id. See also* AFL–CIO 2017 Letter; AARP 2017 Letter.

554 *See, e.g.,* Comment letters on 913 Study, *available at https://www.sec.gov/comments/4-606/4-606.shtml*. Comment letter of Bert Oshiro (Aug. 29, 2010) (''Years ago, I was pretty sure who I was dealing with based on their titles. . . Today it's a totally different story. All kinds of products such as securities, insurance, fee based products, bank accounts, loans, health insurance, auto/homeowners insurance, etc. are sold by people calling themselves: Financial advisors; financial consultants; investment advisors; investment consultants; financial planners; asset managers; financial services advisors; [and] registered representatives. . . It has come to the point that I really don't know who I'm dealing with.''); Comment letter of Larry J. Massung (Aug. 29, 2010) (''I believe there is considerable confusion within the general public with the fiduciary duty, responsibilities, and titles of brokers, dealers and investment advisors''); and Comment letter of Cecylia Escarcega (Aug. 30, 2010) (''Personally, I find the titles confusing because the broker, dealer or investment advisor typically does not tell me what their role is and the scope of their fiduciary duty to me as an investor'').

555 The Commission retained Siegel and Gale in 2004 to conduct the focus group testing in order to determine how investors distinguish the roles, legal obligations, and compensation structures between broker-dealers and investment advisers. *See* Siegel & Gale Study, *supra* note 549.

556 The RAND Study contained two components: (1) An analysis of business practices at broker-dealers and investment advisers based on regulatory filings and interviews with stakeholders (including members of the broker-dealer and investment adviser industries); and (2) a survey of 654 households or focus group testing on household investment behavior and preferences, experience with financial service providers, and understanding of the different types of providers. *See* RAND Study, *supra* note 5.

557 *See* CFA Survey, *supra* note 5.

558 The Commission notes that the results of the Siegel & Gale Study relied on a small sample of focus group testing conducted over a decade ago. While relevant to our understanding of investor perception about broker-dealers and investment advisers, the results of the study may not reliably reflect the current views of the general population of U.S. retail investors.

559 RAND study participants ''commented that the interchangeable titles and 'we do it all' advertisements [by broker-dealers] made it difficult to discern broker-dealers from investment advisers.'' Although the RAND Study indicates that investors are confused the services provided and the titles used by financial professionals, more than 70% of participants also answered that they were ''very satisfied with the service received from the firm,'' that ''they trust the firm acts in their best interest,'' and that ''the firm provides a valuable service.'' These numbers increased to 80% when the length of time spent at a firm was at least 10 years. The Commission notes that the results of the RAND Study relied on testing conducted nearly 10 years ago; therefore, the results of the study may not reliably reflect the current views of the general population of U.S. retail investors

560 *See* RAND Study, *supra* note 5, at 111. The fact sheet provided to RAND Study participants included information on the definition of broker and investment adviser, including a description of common job titles, legal duties and typical compensation. Participants in the RAND Study focus groups indicated that they were confused over common job titles of broker-dealers and investment advisers, thought that because brokers are required to be licensed, investment advisers were not as qualified as brokers, deemed the term ''suitable'' too vague, and concluded that it would be difficult to prove whether or not an investment adviser was not acting in the client's best interest.

561 *See* CFA Study, *supra* note 5.

562 In some circumstances, broker-dealers may owe a fiduciary duty to their customers. For example, there is a body of case law holding that

Continued

i. Fees

The 917 Financial Literacy Study showed that, prior to engaging an investment adviser,[563] approximately 76.4% of survey participants indicated that disclosure of the fees and compensation of investment advisers was an absolutely essential element to any disclosure.[564] With respect to how investors prefer information about fees and compensation to advisers, 23% of respondents preferred a table format with examples, 21% preferred a bulleted format with examples, 20% preferred a bulleted format, and 12% preferred a table format.[565]

In 2015, FINRA conducted an ''Investor Survey'' which included questions about investors' understanding of fees charged for investment services.[566] Approximately 70% of survey participants reported that they thought investment firm (generically referred to as ''adviser'' in the study) compensation and account fees to be very clear, with less than 4% stating that they thought compensation to be unclear. Between 54.7% and 57.6% of respondents indicated that they considered account fees to be ''reasonable,'' while between 0% and 2.3% of respondents indicated that account fees were not reasonable. Of investors that have commission-based accounts, approximately 28% believed that commissions did not affect advice given. Those percentages decline to 15% or less when asked to consider whether selling incentives and third party compensation had not affected the advice provided by investment firms.

TABLE 11—INVESTOR PERCEPTION OF COMPENSATION TO FINANCIAL PROFESSIONALS

[As obtained from the 2015 FINRA Investor Survey]

	Unadvised (%)	Advised: asset fee (%)	Advised: commission-based fee (%)
Advisor Compensation Clear?			
Very	NA	70.9	68.5
Somewhat	NA	27.6	28.0
Not	NA	1.5	3.5
Account Fees Clear?			
Very	68.0	70.3	74.7
Somewhat	29.0	29.7	23.5
Not	2.9	0	1.8
Account Fees Reasonable?			
Agree	55.6	54.7	57.6
Somewhat Agree	42.1	45.3	40.2
Disagree	2.3	0	2.2
Commissions Affect Advice?			
Great Deal	58.3	21.8	29.7
Somewhat	32.8	57.8	42.5
Not At All	8.9	20.4	27.7
Selling Incentives Affect Advice?			
Great Deal	66.1	41.9	44.3
Somewhat	28.4	43.7	40.6
Not At All	5.5	14.4	15.1
Third Party Compensation Affects Advice?			
Great Deal	68.6	32.8	41.4
Somewhat	26.3	56.4	45.3
Not At All	5.1	10.8	13.4

broker-dealers that exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers, owe customers a fiduciary duty, or the scope of obligations that attach by virtue of that duty. *See, e.g., U.S.* v. *Skelly,* 442 F.3d 94, 98 (2d Cir. 2006) (fiduciary duty found ''most commonly'' where ''a broker has discretionary authority over the customer's account''); *United States* v. *Szur,* 289 F.3d 200, 211 (2d Cir. 2002) (''Although it is true that there 'is no general fiduciary duty inherent in an ordinary broker/customer relationship,' a relationship of trust and confidence does exist between a broker and a customer with respect to those matters that have been entrusted to the broker.'') (citations omitted); *Leib* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 461 F. Supp. 951, 953–954 (E.D. Mich. 1978), *aff'd,* 647 F.2d 165 (6th Cir. 1981) (recognizing that a broker who has de facto control over non-discretionary account generally owes customer duties of a fiduciary nature; looking to customer's sophistication, and the degree of trust and confidence in the relationship, among other things, to determine duties owed); Arleen W. Hughes, Exchange Act Release No. 4048 (Feb. 18, 1948) (Commission Opinion), *aff'd sub nom. Hughes* v. *SEC,* 174 F.2d 969 (D.C. Cir. 1949) (noting that fiduciary requirements generally are not imposed upon broker-dealers who render investment advice as an incident to their brokerage unless they have placed themselves in a position of trust and confidence, and finding that Hughes was in a relationship of trust and confidence with her clients).

[563] The 917 Financial Literacy Study, *supra* note 20, uses the term financial intermediary when discussing the importance of certain disclosures of firms or financial professionals.

[564] *See* 917 Financial Literacy Study, *supra* note 20, at 67.

[565] 23% of respondents also preferred the ''status quo''—''the way it was presented'' in the example.

[566] *See* FINRA Report on Conflicts of Interest, (Oct. 2013), at 6, *available at http://www.finra.org/sites/default/files/Industry/p359971.pdf* (''Investor Survey'').

Academic evidence also indicates that retail investors exhibit limited understanding of the fees and commissions of financial products. Several academic studies show that even when disclosures are provided to investors, investors experience difficulty in accounting for and understanding how fees affect their financial choices.[567]

j. Conflicts of Interest

Studies have found that investors consider conflicts of interest to be an important factor in the market for financial advice. For example, in the 917 Financial Literacy Study,[568] approximately 52.1% of survey participants indicated that an essential component of any disclosure would be their financial intermediary's conflicts of interest, while 30.7% considered information about conflicts of interest to be important, but not essential. Investors also were asked to rate their level of concern about potential conflicts of interest that their adviser might have. Approximately 36% of the investors expressed concerns that their adviser might recommend investments in products for which its affiliate receives a fee or other compensation, while 57% were concerned that their adviser would recommend investments in products for which it gets paid by other sources. In addition to conflicts directly related to compensation practices of financial professionals, some investors were concerned about conflicts related to the trading activity of these firms. For example, more than 26% of participants were concerned that an adviser might buy and sell from its account at the same time it is recommending securities to investors; and more than 55% of investors were also concerned about their adviser's engaging in principal trading.

Approximately 70% of the participants in the 917 Financial Literacy Study indicated that they would read disclosures on conflicts of interest if made available, with 48% requesting additional information from their adviser, 41% increasing the monitoring of their adviser, and 33% proposing to limit their exposure of specific conflicts. The majority of investors (70%) also wanted to see specific examples of conflicts and how those related to the investment advice provided. Academic research also suggests that information about conflicts of interest could improve individual decisions.[569]

k. Disciplinary History

Survey evidence indicates that knowledge of a firm's and financial professional's disciplinary history is among the most important items for retail investors deciding whether to receive financial services from a particular firm, according to one study.[570] Despite this, most investors do not actively seek disciplinary information for their advisers and broker-dealers.[571] A recent FINRA survey, however, found that only 15% of survey respondents checked their financial professional's background, although the Commission notes that the study encompasses a wide group of advisers, such as debt counselors and tax professionals.[572] Another FINRA survey found that only 7% of survey respondents use FINRA's BrokerCheck and approximately 14% of survey respondents are aware of the Investment Adviser Public Disclosure (IAPD) website.[573]

B. Form CRS Relationship Summary

1. Broad Economic Considerations

We are proposing to require broker-dealers, investment advisers, and firms that are dually registered to deliver a relationship summary to retail investors.[574] The economic tradeoffs involved in disclosures made by financial firms and financial professionals are complex and affected by a wide range of factors, which we consider in more detail below. In this section, we discuss the characteristics of disclosures that may effectively convey information that is useful to retail investors when they are searching for a financial firm and to facilitate matching between retail investors' expectations and the choice of financial firm or financial professional.

Disclosure requirements provide benefits to participants in financial markets because disclosing parties may lack private incentives to voluntarily disclose or standardize relevant information.[575] Disclosure can benefit not only investors but also the disclosing parties,[576] as well as provide indirect benefits to financial markets.[577]

[567] Experimental evidence from the U.S. mutual fund market is provided by, James J. Choi, David Laibson, & Brigitte C. Madrian, *Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds* Review of Financial Studies 23(4): 1405–1432 (Nov. 14, 2009) (''Choi Laibson Article'') (finding that experimental subjects fail to minimize fees among four different actual S&P 500 index funds and 80–90% of the subjects in the study presented with simplified fee disclosures still failed to select the lowest-priced options among products with similar characteristics). Field-based evidence from the payday loans market is provided by, Marianne Bertrand & Adair Morse, *Information Disclosure, Cognitive Biases, and Payday Borrowing,* The Journal of Finance 46(6): 1865–1893 (Nov. 14, 2011). For a comprehensive survey of the literature see George Loewenstein, Cass R. Sunstein, & Russell Golman, *Disclosure: Psychology Changes Everything,* Annual Review of Economics 6: 391–419 (Aug. 2014) (''Loewenstein Sunstein Article'').

[568] Section 917 of the Dodd-Frank Act further required the Commission to conduct a study to identify the level of financial literacy among retail investors as well as methods and efforts to increase the financial literacy of investors. *See* 917 Financial Literacy Study, *supra* note 20.

[569] *See* S. Sah & G. Loewenstein, *Nothing to declare: Mandatory and voluntary disclosure leads advisors to avoid conflicts of interest,* Psychological Science 25, 575–584 (2014).

[570] *See* 917 Financial Literacy Study, *supra* note 20, at nn. 311 and 498 and accompanying text (Approximately 67.5% of the online survey respondents considered information about an adviser's disciplinary history to be absolutely essential, and about 20.0% deemed it important, but not essential, and ''When asked how important certain factors would be to them if they were to search for comparative information on investment advisers, the majority of online survey respondents identified the fees charged and the adviser's disciplinary history as the most important factors.'').

[571] For example, the FINRA 2015 Investor Survey finds that only 24% of investors are aware of Investor.gov; only 16% are aware of BrokerCheck; only 14% are aware of the IAPD website, and only 7% have used BrokerCheck. Investor Survey, *supra* note 566.

[572] 2009 National Survey Initial Report, *supra* note 275.

[573] *See* Investor Survey, *supra* note 566.

[574] *See supra* Section II.

[575] *See, e.g.,* Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Exchange Act Release No. 8358 (Jan. 29, 2004) [69 FR 6437 (Feb. 10, 2004)] (''The Commission believes that permitting investors to more readily obtain information about distribution-related costs that have the potential to reduce their investment returns and to give investors a better understanding of some of the distribution-related arrangements that create conflicts of interest for brokers, dealers, municipal securities dealers, and their associated natural persons. The disclosure of information about these costs and arrangements can help investors make better informed investment decisions.''). *See also* P. Healy & K. Palepu, *Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical corporate disclosure literature,* Journal of Accounting and Economics 31, 405–440 (2001).

[576] *See,* Michael Jensen & William Meckling, *Theory of the firm: Managerial behavior, agency costs, and ownership structure,* Journal of Financial Economics 3, 305–360 (1976); Patel, S. and G. Dallas, *Transparency and disclosure: Overview of methodology and study results,* United States, Standard & Poor's, New York (2002); A. Ferrell, *Mandatory disclosure and stock returns: Evidence from the over-the-counter market,* The Journal of Legal Studies 36, 213–253 (2007). Regarding the effect of corporate disclosures on improved corporate governance, *see, e.g.* B. Hermalin & M. Weisbach, *Transparency and corporate governance,* NBER Working paper No. W12875 (2007); R. Lambert, C. Leuz, & R. Verrecchia, *Accounting information, disclosure, and the cost of capital,* Journal of Accounting Research 45, 385–420 (2007).

[577] *See* L. Holder-Webb, J. Cohen, L. Nath, & D. Wood, *A survey of governance disclosures among U.S. firms,* Journal of Business Ethics 83, 543–563 (2008); Z. Rezaee, *Causes, consequences, and*

Continued

Although the majority of the information proposed for Form CRS may be publicly available in a number of existing regulatory forms and platforms, including, for example, Form ADV (and IAPD) or BrokerCheck, or may be included in disclosures developed to meet disclosure requirements under DOL regulations or exemptions, such as the BIC Exemption, the Commission preliminary believes that all retail investors would benefit from short summary disclosure that focuses on certain aspects of a firm and its services to retail investors which could be supplemented by additional disclosure. Like other public-facing disclosures, the objective of Form CRS would be to provide relevant and reliable information to investors. The relationship summary would apply to a broad array of relationships, spanning different firms as well as both retirement and non-retirement accounts.[578] By requiring both investment advisers and broker-dealers to deliver to existing and prospective retail investors and file a publicly available concise relationship summary that discusses, in one place, both types of services and their differences, the proposed rules for Form CRS would also help retail investors to compare certain different types of accounts and firms.

Given that most of the information provided by Form CRS would already have been made available by investment advisers through other regulatory disclosures, and by some broker-dealers through contracts or other voluntary disclosures, the focus of this economic analysis is on the effects of the format and structure of the proposed Form CRS disclosures. Studies have found that the format and structure of disclosure may improve (or decrease) investor understanding of the disclosures being made.[579]

Before elaborating on the characteristics of an effective disclosure regime, we note that some studies undertaken outside the market for financial services find that sometimes certain disclosures may result in unintended consequences. In general, the structure of the disclosure may affect the choices that investors make. Every disclosed item not only presents a piece of new information to retail investors but also provides a frame within which all other items are evaluated.[580] This framing effect could lead investors to draw different conclusions depending on how information is presented. For example, if the disciplinary history information is presented first, it could affect the way investors perceive all subsequent disclosures in the relationship summary and, possibly, discount more heavily the information provided by firms with disciplinary events than by firms with clean record. The effect of the disciplinary history information would be moderated if this information is provided at the end of the relationship summary.

Existing research has also found that conflict of interest disclosures can increase the likelihood that the disclosing party would act on the conflict of interest.[581] This bias can be caused by ''moral licensing,'' a belief that the disclosing party has already fulfilled its moral obligations in the relationship and therefore can act in any way, or it can be caused by ''strategic biasing,'' aimed at compensating the disclosing party for the anticipated loss of profit due to the disclosure.[582] Experimental evidence also suggests that disclosure could turn some clients or customers into ''reluctant altruists.'' [583] For example, if financial professionals disclose that they earn a referral fee if a customer enrolls in a program, the customer may implicitly feel that they are being asked to help their financial professional receive the fee. One study also found evidence that disclosure of a professional's financial interests (particularly in face-to-face interactions) can induce a panhandler effect, whereby customers may face an implicit social pressure to meet the professional's financial interests.[584] The above literature indicates that conflicts of interest disclosures could undermine the intended benefits of the disclosures for investors if investors become reluctant altruists or feel an obligation to succumb to the panhandler effect. However, these studies also suggest certain factors that may mitigate the unintended consequences. For example, in the case of the ''panhandler effect,'' researchers have found that distancing the client or customer from the financial professional either in the decision or disclosure phase can dampen this effect.[585]

Academic research has identified a set of characteristics, including targeted and simple disclosures, salience, and standardization, that may increase the effectiveness of a disclosure regime. Adhering to these characteristics is expected to increase the benefits of a disclosure document to consumers. These characteristics, discussed below, frame our analysis of the economic impacts of the proposed rule.[586]

First, existing research demonstrates that individuals exhibit limited ability to absorb and process information.[587] These cognitive limitations suggest that more targeted and simpler disclosures may be more effective in communicating information to investors than more complex disclosures. As discussed more thoroughly below, costs, such as increased investor confusion or reduced understanding of the key elements of the disclosure, are likely to

deterrence of financial statement fraud, Critical Perspectives on Accounting 16, 277–298 (2005).

[578] For comparison, the disclosure conditions under applicable DOL regulations and exemptions apply only to financial firms and financial professionals servicing IRAs and ERISA-covered retirement plans and participants in such plans.

[579] *See,* Justine S. Hastings & Lydia Tejeda-Ashton, *Financial Literacy, Information, and Demand Elasticity: Survey and Experimental Evidence from Mexico,* NBER Working Paper 14538 (Dec. 2008) (finding that providing fee disclosures to Mexican investors in peso rather than percentage terms caused financially inexperienced investors to focus on fees); *See,* Richard G. Newell & Juha Siikamaki, *Nudging Energy Efficiency Behavior,* Resources for the Future Discussion Paper 13–17 (Jul. 10, 2013) (finds that providing dollar operating costs in simplified energy efficiency labeling significantly encouraged consumers to choose higher energy efficiency appliances, while another related study presents similar evidence from payday loans).

[580] *See* Tversky, A., Kahneman, D., 1981. The framing of decisions and the psychology of choice. Science 211, 453–458 (''Tversky Kahneman Article'').

[581] *See,* Daylian Cain, George Loewenstein & Don Moore, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest,* Journal of Legal Studies 34: 1–25 (Jan. 2005) (''Cain 2005 Article''); Daylian Cain, George Loewenstein & Don Moore, *When Sunlight Fails to Disinfect: Understanding the Perverse Effects of Disclosing Conflicts of Interest,* Journal of Consumer Research 37: 1–45 (Aug. 27, 2010); Bryan Church & Xi Kuang, *Conflicts of Disclosure and (Costly) Sanctions: Experimental Evidence,* Journal of Legal Studies 38 2: 505–532 (Jun. 2009); Christopher Tarver Robertson, *Biased Advice,* Emory Law Journal 60: 653–703 (Feb. 17, 2011). These papers study conflicts of interest in general, experimental settings, not specialized to the provision of financial advice.

[582] Although disclosures in general may cause negative unintended consequences, existing rules and regulations for broker-dealers and investment advisers, as well as proposed Regulation Best Interest, are likely to moderate the effects of moral licensing or strategic bias for financial professionals.

[583] *See* J. Dana, D. Cain & R. Dawes, *What you don't know won't hurt me: Costly (but quiet) exit in dictator games,* Organizational Behavior and Human Decision Processes 100:193–201 (2006).

[584] Daylian Cain, George Loewenstein & Don Moore, *The burden of disclosure: Increased compliance with distrusted advice,* Journal of Personality and Social Psychology, 104(2): 289–304 (2013) (''Burden of Disclosure Article'').

[585] *See id.*

[586] *See* Loewenstein Sunstein Article, *supra* note 567. The paper provides a comprehensive survey of the literature relevant to disclosure regulation.

[587] *See* Nisbett RE & Ross L. *Human Inference: Strategies and Shortcomings of Social Judgment* (1980). Englewood Cliffs, NJ: Prentice Hall. David Hirshleifer & Siew Hong Teoh, *Limited attention, information disclosure, and financial reporting,* Journal of Accounting and Economics 36, 337–386 (Dec. 2003).

increase as disclosure documents become longer, more convoluted, or more reliant on narratives.[588] Moreover, empirical evidence suggests that simplification benefits consumers of disclosed information.[589] These results appear to support requirements of simple disclosures, which provide benefits to consumers of that information.

A second characteristic of an effective disclosure is salience, or the tendency to 'stand out' or contrast with other information on a page. Salience detection is a key feature of the human cognition allowing individuals to focus their limited mental resources on a subset of the available information and causing them to over-weight this information in their decision making processes.[590] Within the context of disclosures, more salient information, such as information presented in bold text, would be more effective in attracting attention than less salient information, such as information presented in a footnote. There is also empirical evidence that visualization improves individual perception of information.[591] For example, one experimental study shows that tabular reports lead to better decision making and graphical reports lead to faster decision making (when people are subject to time constraints).[592]

A third characteristic of effective disclosure is standardization. People are generally able to make more coherent and rational decisions when they have comparative information that allows them to assess relevant trade-offs.[593] Standardization could be particularly important for the disclosure of certain quantitative aspects of financial services, such as the level and structure of fees.

Finally, personalization may further enhance the effectiveness of disclosure.[594] This approach might involve, for example, adjusting the presentation to take account of the receiver's interests, expectations, or format preferences or to tailor the information based on what the receiver already knows in order not to repeat existing knowledge. Personalization is usually achieved at the expense of standardization, however, and can be costly to create.

Current reporting and disclosure requirements for broker-dealers and registered investment advisers including Form BD and Form ADV may provide detailed information to investors. However, because these existing reports and disclosures (which serve the purposes for which they were created) are made in multiple, sometimes lengthy forms, and made available at different websites or delivery methods, it can be difficult for investors to grasp the most important features of the financial services and products they receive. In addition, the information available to retail investors about broker-dealers on BrokerCheck does not include the same information that investment advisers provide in the Form ADV brochure and brochure supplement. The relatively low financial literacy of many investors also makes it less likely that they would be able to effectively compile this information on their own and use it in their decision making. Furthermore, most financial firms and professionals could lack the incentives and resources to disclose the main aspects of their business practices to their customers in the absence of the proposed requirements.

In evaluating the broad economic issues related to disclosure, the Commission preliminarily believes that all retail investors would benefit from a short summary that focuses on certain aspects of the firm and its financial professionals and its services. By requiring both investment advisers and broker-dealers to provide a concise relationship summary that discusses both types of services and their differences, the relationship summary would help all retail investors to understand these aspects of a particular firm, to compare different types of accounts, and to compare one firm with other firms. The relationship summary would also highlight, in one place, the services, some categories of fees, specified conflicts of interest, and whether the firm or its financial professionals currently have reportable disciplinary events.

2. Economic Effects of the Relationship Summary

This section analyzes the anticipated economic effects from the proposed relationship summary to the directly affected parties: retail investors, and broker-dealers and investment advisers that offer brokerage or advisory services to retail investors.[595]

a. Retail Investors

As noted above, substantial evidence suggests that retail investors lack financial literacy and do not understand many basic financial concepts, such as the implications of investment costs for investment performance.[596] This, in turn, supports the notion that a well-functioning market for financial services may provide benefits to investors by helping them obtain information and guidance from firms and financial professionals and thereby make better investment decisions. At the same time, however, evidence also suggests that investors do not fully comprehend the nature of the business relationships and responsibilities in the market which makes them vulnerable to confusion and being misled by firms and financial professionals;[597] it also implies that any improvement of retail investor understanding of their relationship with

[588] *See, e.g.,* S.B. Bonsall IV & B.P. Miller, *The Impact of Narrative Disclosure Readability on Bond Ratings and the Cost of Capital,* The Review of Accounting Studies 2 (2017) and A. Lawrence, *Individual Investors and Financial Disclosure,* Journal of Accounting & Economics 56, 130–47 (2013).

[589] *See supra* notes 35, 46—48 and accompanying text. *See also* S. Agarwal, S. Chomsisengphet, N. Mahoney & J. Stroebel, *Regulating consumer financial products: evidence from credit cards,* NBER Working Paper 19484 (Jun. 2014) (finding that a series of requirements in the Credit Card Accountability Responsibility and Disclosure Act (CARD Act), including several provisions designed to promote simplified disclosure, has produced substantial decreases in both over-limit fees and late fees, thus saving U.S. credit card users $12.6 billion annually).

[590] Daniel Kahneman, *Thinking, Fast and Slow,* New York: Farrar, Strauss, Giroux (2013). Susan Fiske & Shelley E. Taylor, *Social cognition: From Brains to Culture,* SAGE Publications Ltd; 3rd ed. (2017).

[591] J. Hattie, *Visible learning. A synthesis of over 800 meta-analyses relating to achievement,* Oxon: Routledge (2008) (''Hattie'').

[592] I. Benbasat & A.S. Dexter, *An Investigation of the Effectiveness of Color and Graphical Presentation under Varying Time Constraints,* MIS Quarterly 10, 59–83 (Mar. 1986) (''Benbasat & Dexter'').

[593] *See, e.g.,* JR Kling, S. Mullainathan, E. Shafir, LC Vermeulen & MV Wrobel, *Comparison friction: experimental evidence from Medicare drug plans,* Quarterly Journal of Economics 127, 199–235 (2012) (finding that in a randomized field experiment, in which some senior citizens choosing between Medicare drug plans that were randomly selected to receive a letter with personalized, standardized, comparative cost information (''the intervention group'') while another group (''the comparison group'') received a general letter referring them to the Medicare website, plan switching was 28% in the intervention group, but only 17% in the comparison group, and the intervention caused an average decline in predicted consumer cost of about $100 a year among letter recipients); CK Hsee, GF Loewenstein, S. Blount & MH Bazerman, *Preference reversals between joint and separate evaluations of options: a review and theoretical analysis,* Psychological Bulletin 125, 576–590 (Oct. 2006).

[594] *See* Loewenstein Sunstein Article, *supra* note 567.

[595] Economic effects of the proposal on the market for financial services, including on indirectly-affected parties such as banks or insurers that are not regulated by the SEC, are considered in the following section.

[596] *See* 917 Financial Literacy Study, *supra* note 20.

[597] *See* 913 Study, *supra* note 3, at section III.A.; Siegel & Gale Study, *supra* note 550; RAND Study, *supra* note 5.

financial professionals could improve investor's investment decisions.

The content of the proposed relationship summary is intended to alert retail investors to information that would help them to choose a firm or a financial professional and prompt retail investors to ask informed questions. It is also intended to facilitate comparisons across firms that offer the same or substantially similar services. Specifically, the relationship summary would provide information on the relationships and services offered by investment advisers and broker-dealers, the standards of conduct applicable to those services, certain categories of fees and costs of the services offered, comparisons of brokerage and investment advisory services (for standalone broker-dealers and investment advisers),[598] conflicts of interest, and some additional information, including the existence of currently reportable legal or disciplinary events. The Commission believes that the information in the relationship summary could help alleviate investor confusion and would promote effective communication between the firm and its retail investors and assist investors in making an informed choice when choosing an investment firm and professional and type of account to help to ensure they receive services that meet their preferences and expectations. Although the relationship summary applies only to broker-dealers and registered investment advisers, its impact could extend beyond the current and prospective clients of these institutions and impact a larger set of investors through various channels such as public filings and website posting. Both the content and the form of the relationship summary are designed to increase the likelihood that the disclosed information is consumed easily and effectively by retail investors. We discuss the potential benefits and costs of the relationship summary and its components in detail below.

i. Structure of the Relationship Summary

The structure of the relationship summary is designed to facilitate retail investors' absorption of the provided information. The proposed design intentionally restricts the length of the relationship summary, whether in electronic or paper format, to four pages on 8½ x 11 inch paper if converted to PDF format, with a specified font size and margin requirements. Existing research suggests that shorter disclosures help investors absorb and process information.[599] Shorter disclosure would also facilitate a layered approach to disclosure. The Commission acknowledges that a limit on overall document length (or equivalent length for electronic disclosure) may entail limiting the information provided through the relationship summary. However, based on the studies described above, we preliminarily believe that limiting the length of the relationship summary appropriately trades off the benefits of additional detail against the costs of increased complexity associated with longer disclosures. Similarly, while the required standardization across the relationship summary limits the ability of firms to provide customized information to potential retail investors, we preliminarily believe these constraints are appropriate to facilitate comparability.

In addition, firms would be required to use short sentences, active voice, and plain language throughout the relationship summary. Firms would not be permitted to use legal jargon, highly technical business terms, or multiple negatives. Existing research also shows that visualization helps individuals absorb information more efficiently.[600] Consistent with this research, firms would be permitted to use graphical presentations, and dual registrants would be required in certain aspects, to use tables to simplify and highlight the information. For example, dual registrants will be required to provide a side-by-side tabular presentation of all relevant information provided in the relationship summary.

Moreover, the disclosure would involve a certain degree of standardization across firms. In particular, firms would be required to use the same headings, prescribed wording, and present the information under the headings in the same order.[601] Additionally, firms would be prohibited from adding any items to those prescribed by the Commission and any information other than what the Instructions require or permit. As discussed above, standardization facilitates comparisons of content across disclosures.[602] We believe that allowing only the required and permitted information would promote standardization of the information presented to retail investors, and would allow retail investors to focus on information that we believe is particularly helpful in deciding among firms. At the same time, we acknowledge that standardization of disclosures not only limits personalization that may be valuable to retail investors but also could result in disclosures that are less precise. Further, all information in the relationship summary must be true and not misleading. In particular, the Instructions permit firms to omit or modify any prescribed statement that is inapplicable to their business or would be misleading to a reasonable retail investor. In addition, for certain items, firms will have some flexibility in how they include the required information.

ii. Introduction

The proposed Introduction of the relationship summary would highlight to retail investors the type of accounts and services the firm offers to retail investors, and the firm's SEC registration status. In addition, the introduction would require prescribed wording stating there are different ways for investors to get help with their investments, and that they should carefully consider what type of account and services would be right for them and that there are suggested questions at the end of the disclosure. An introduction designed in this manner may benefit retail investors by clarifying that there are choices available in terms of accounts and services and that the some services, firms, or financial professionals may be a better fit than others for the investor. This in turn may trigger a closer read of the relationship summary and perhaps also additional information gathering by the investor that could lead to a more informed choice of financial professional and better fit between the investor's need and the type of accounts and services they use.

iii. Relationships and Services

In the second section of the relationship summary, firms would discuss specific information about the nature, scope, and duration of its relationships and services, including the types of accounts and services the firm offers, how often it offers investment advice, and whether the firm monitors

[598] For purposes of the relationship summary, we propose to define a standalone investment adviser as a registered investment adviser that offers services to retail investors and (i) is not dually registered as a broker-dealer or (ii) is dually registered as a broker-dealer but does not offer services to retail investors as a broker-dealer. We propose to define a standalone broker-dealer as a registered broker-dealer that offers services to retail investors and (i) is not dually registered as an investment adviser or (ii) is dually registered as an investment adviser but does not offer services to retail investors as an investment adviser. Proposed General Instruction 9.(f) to Form CRS.

[599] *See supra* Section IV.B.1.

[600] *See* commenters' feedback in the Financial Literacy Study, *supra* note 20, at iv, xx, 21–22.

[601] *See supra* note 593.

[602] *See supra* Section IV.B.1.

the account. As noted above, the relationships and services of firms can differ in nature, scope, and duration. The Commission believes that a better understanding of the relationships and services could lower search costs and the risk of mismatch for retail investors, by facilitating cross-firm comparisons, and make it easier for them to find a firm and a financial professional that most closely meet their expectations, depending on how important different types of fee structures, services, standards of conduct or other information points are to them.

iv. Obligations to the Retail Investor—Standard of Conduct

The third section of the relationship summary briefly describes in plain language the firm's legal standard of conduct. As noted above, studies show that many retail investors are confused about the standard of conduct that applies to firms and financial professionals,[603] and the Commission believes that providing retail investors with a brief description of legal obligations of firms and professionals could help alleviate this confusion. Furthermore, to the extent this section makes the issue of standard of conduct more salient to the investors, it may encourage additional information gathering by the investors about the standard of conduct, which could further increase investors' understanding.

Investor understanding of the obligations of their firms and financial professionals with respect to each type of account could help investors align their expectations with the expected conduct of their firm or financial professional. For example, depending on their preferences, some investors might find an advisory account more appropriate. Other investors could prefer the services and standards of conduct associated with a brokerage account. Thus, to the extent the proposed disclosure of obligations in the relationship summary increase investors understanding in this area, it may improve the match between investors' preferences and expectations and the type of accounts and services they select while preserving investor choice.

v. Summary of Fees and Costs

The Commission is also proposing that firms include an overview of specified types of fees and expenses that retail investors will pay in connection with their brokerage and investment advisory accounts.[604] This section would include a description of the principal type of fees that the firm will charge retail investors as compensation for the firm's advisory or brokerage services, including whether the firm's fees vary and are negotiable, and factors that would help a reasonable retail investor understand the fees that he or she is likely to pay. As such, the improved disclosure of the categories of fees, including wrap fees, could help improve retail investor's decision to engage a firm and a financial professional.

vi. Comparisons

The Commission is also proposing to require standalone investment advisers and standalone broker-dealers to provide comparisons to the other type of firm. Standalone broker-dealers would include information about the following: (i) The primary types of fees that investment advisers charge; (ii) services generally provided by investment advisers, (iii) advisers' standard of conduct; and (iv) certain incentives advisers have based on the investment adviser's asset-based fee structure. For investment advisers, this section would include parallel categories of information regarding broker-dealers.

The choice between a brokerage account and an advisory account in part may determine the types of fees and costs and standard of conduct associated with the account. Retail investors who are provided with more information would be more likely to match their choice of the type of account with their expectations; if retail investors do not understand the differences between of broker-dealers and investment advisers, they are less likely to be able to match their expectations for financial services providers with their choices. Thus, the Commission preliminary believes that having a clear explanation of differences in the fees, scope of services, standard of conduct, and incentives that are generally relevant to advisory and brokerage accounts may help retail investors who are considering one such type of relationship to compare how their preferences and expectations might be better met with the other type of relationship.

vii. Conflicts of Interest

The Commission is also proposing that firms summarize their conflicts of interest related to certain financial incentives. Specifically, firms would be required to disclose conflicts relating to: (i) Financial incentives to offer to, or recommend that the retail investor invest in, certain investments because (a) such products are issued, sponsored, or managed by the firm or its affiliates, (b) third parties compensate the firm when it recommends or sells the investments, or (c) both; (ii) financial incentives to offer to, or to recommend that the retail investor invest in, certain investments because the manager or sponsor of those investments or another third party (such as an intermediary) shares revenue it earns on those products with the firm; and (iii) the firm buying investments from and selling investments to a retail investor from the firm's account (*i.e.,* principal trading). Including these disclosures prominently, in one place, at or before the start of a retail investor's relationship with a firm or financial professional could facilitate retail investors' understanding of the incentives that may be present throughout the course of the relationship. Such disclosure of financial incentives could assist investors in matching their expectations when choosing a firm or professional and type of account to help to ensure they receive services that meet their expectations. In addition, to the extent that the specified conflicts of interest disclosures could draw retail investors' attention to conflicts, monitoring of firms and financial professionals by retail investors could be improved.

The first category of conflicts noted above makes the promotion of own and third party products more salient for retail investors. The possibility that an investor may request an explanation of a transaction regarding a recommended investment or strategy, and associated costs thereof, could serve as an additional disciplinary device for firms and financial professionals and align better their interests with the interests of retail investors. Similarly, the disclosures in the relationship summary about revenue sharing arrangements may induce retail investors to more carefully pay attention to investments with such arrangements and request further information. Principal trading could also make retail investors vulnerable to transactions that transfer value from their accounts to the accounts of the firm, and so the disclosure of principal trading information could draw retail investors' attention to possible conflicts that could emerge from principal transactions and generate increased scrutiny of such transactions by investors.

While the Commission preliminarily believes that disclosures of conflicts of

[603] *See, e.g.,* Siegel & Gale Study, *supra* note 5 and RAND Study, *supra* note 5. *See also* CFA Survey, *supra* note 5.

[604] *See supra* Section II.B.4.

interest in the relationship summary could match retail investor expectations with the choices of firms and financial professionals, some studies have found that disclosures of conflicts of interest, in some cases, could undermine the motivations of people to behave ethically or to take moral license in their actions.[605] In the context of providing investment advice, the perception that an investor has been warned (via the disclosure) of a firm's and financial professional's potential bias may make them believe that they are less obligated to provide unbiased advice.[606] Further, other studies have suggested that disclosures of conflicts of interest could also make firms and financial professionals appear more trustworthy and as a result reduce the incentives for retail investors to examine additional information more carefully.[607] The Commission preliminarily believes, however, that the securities laws and existing rules and regulations thereunder, such as investment advisers' fiduciary duty,[608] broker-dealers' requirements under proposed Regulation Best Interest[609] standard, as well as under existing self-regulatory organizations' rules and the Exchange Act,[610] reduce the risk that broker-dealers and investment advisers might use the proposed relationship summary to exploit potential conflicts of interest between themselves and their retail investors because these regulations may raise the cost of misconduct.[611]

viii. Additional Information

To facilitate the layered disclosure that the relationship summary provides, we are proposing to require that firms include a separate section (''Additional Information'') in the relationship summary outlining where retail investors can find more information about the firm's legal and disciplinary events, services, fees, and conflicts.

Retail investors may benefit from information on where to find disclosures of the disciplinary events of firms and financial professionals. For some retail investors, the disciplinary history of the firm or the financial professional may affect their choices related to obtaining investment advice. By providing information on whether the firm or financial professionals have disciplinary history and where to obtain more detailed information through layered disclosure may facilitate retail investors' ability to match their expectations with their choice of financial service provider. The required disclosure would succinctly state whether or not the firm or its financial professionals have legal and disciplinary events, based on whether or not they or their financial professionals currently disclose or are currently required to disclose certain legal or disciplinary events to the Commission, self-regulatory organizations, state securities regulators or other jurisdictions, as applicable. The Additional Information section would also highlight where retail investors can find more information about the disciplinary history of the firm and its financial professionals on ''*Investor.gov.*'' While the disclosure of the existence of disciplinary events does not provide new information to the market,[612] this simple disclosure in the relationship summary, if applicable, could help retail investors more easily identify firms that have reported disciplinary events for themselves or their financial professionals and where to find more information about the events. By including this disclosure, in combination with the requirement to include a specific question for retail investors to ask about disciplinary history in the ''Key Questions to Ask'' section (discussed further below), the relationship summary would potentially make retail investors more likely to seek out disciplinary history information to use in their evaluation of firms and financial professionals and would make them better informed when they choose a firm and a financial professional. Finally, retail investors themselves have indicated that they consider disciplinary information important.[613]

Further, by drawing attention to disciplinary histories of financial professionals for retail investors, firms could become more selective in their employment decisions, which could benefit retail investors by having a potentially more trustworthy pool of financial professionals to select from when they choose providers of investment advice, and reduce potential harm to retail investors. As such, the overall quality of financial advice provided to retail investors could increase, to the extent that legal and regulatory compliance is correlated with advice quality.[614] As a consequence, such disclosures of disciplinary history could promote retail investor confidence in the market.

One potential cost of the increased salience of the existence of disciplinary events may be that retail investors could

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[605] *See* Geneviève Helleringer, *Trust Me, I Have a Conflict of Interest! Testing the Efficacy of Disclosure in Retail Investment Advice,* Oxford Legal Studies Research Paper No. 14/2016 (Mar. 2016), *available at https://ssrn.com/abstract=2755734*; and Cain 2005 Article, *supra* note 581. As discussed above, existing and proposed rules and regulations for broker-dealers and investment advisers could mitigate the negative unintended consequences of disclosures of conflicts of interest.

[606] *See supra* Section IV.B.1.

[607] *See* Burden of Disclosure Article, *supra* note 584. Further, this ''panhandler effect'' suggests that in some cases disclosure of financial professionals' conflicts of interests (particularly in face-to-face interactions) may create social pressure on retail investors to meet the financial professionals' interests.

[608] Under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interest of its clients, including an obligation not to subrogate clients' interest to its own. *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. at 194 (the United States Supreme Court held that, under section 206 of the Investment Advisers Act of 1940, advisers have an affirmative obligation of utmost good faith and full and fair disclosure of all material facts to their clients, as well as a duty to avoid misleading them). Section 206 applies to all firms and persons meeting the Advisers Act's definition of investment adviser, whether registered with the Commission, a state securities authority, or not at all. *See also Transamerica Mortgage Advisors, Inc.* v. *Lewis,* 444 U.S. 11, 17 (1979) (''[T]he Act's legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations.'').

[609] *See* Regulation Best Interest Proposal, *supra* note 24. Proposed Regulation Best Interest would establish a standard of conduct for broker-dealers and associated persons of broker-dealers to act in the best interest of the retail customer at the time at recommendation is made without placing the financial or other interest of the broker-dealer or associated person of a broker-dealer ahead of the interest of the retail customer. The standard of conduct obligation shall be satisfied if the broker-dealer or associated person of the broker-dealer discloses at the time of the recommendation material facts relating to the scope and terms of the relationship, which may be satisfied in part by the relationship summary, and all material conflicts associated with the recommendation. In addition, broker-dealers would be required to satisfy the Care and Conflicts of Interest Obligations, as discussed more fully in the Regulation Best Interest Proposal.

[610] For example, a broker-dealer may recommend a security even when a conflict of interest is present, but that recommendation must be suitable. *See* FINRA Rule 2111. The antifraud provisions of the federal securities laws and the implied obligation of fair dealing prohibit a broker-dealer from, among other things, making unsuitable recommendations and require broker-dealers to investigate an issuer before recommending the issuer's securities to a customer. *See, e.g., Hanly* v. *SEC,* 415 F.2d 589, 596 (2d Cir. 1969). *See also* Municipal Securities Disclosure, Exchange Act Release No. 26100 (Sept. 22, 1988), at n.75. The fair dealing obligation also requires a broker-dealer to reasonably believe that its securities recommendations are suitable for its customer in light of the customer's financial needs, objectives and circumstances (customer-specific suitability). *See* Release 8662, *supra* note 118, at 18 (involving excessive trading and recommendations of speculative securities without a reasonable basis).

[611] Consistent with this belief, one study also finds that regulations and legal sanctions on conflicted advice can mitigate the effects of moral licensing discussed above. *See* Bryan Church & Xi Kuang, *Conflicts of Disclosure and (Costly) Sanctions: Experimental Evidence,* Journal of Legal Studies 38 2: 505–532 (Jun. 2009).

[612] *See* Parts 1 and 2 of Form ADV; Form BD; Form U4.

[613] *See* 917 Financial Literacy Study, *supra* note 20.

[614] *See* Mark Egan, Gregor Matvos & Amit Seru, *The Market for Financial Adviser Misconduct,* Journal of Political Economy (Dec. 14, 2017), *available at https://ssrn.com/abstract=2739170.*

be deterred from hiring a firm or financial professional with a disciplinary record, even if they would be better off to do so, without further investigating the nature of the disciplinary event. Alternatively, an investor may also incorrectly assume that a firm that does not report legal/disciplinary history is a ''better'' or a ''more compliant'' firm than a firm that does report such history; *i.e.,* the lack of currently reportable disciplinary history could signify a stamp of approval for some investors. Therefore, disclosures of the existence of disciplinary events could have an unintended consequence of keeping some investors out of the market for financial advice or by selecting financial professionals that could lead to a mismatch with the expectations of the retail investor.

This section would also include disclosure of how investors can contact the firm, the SEC, or FINRA (when applicable) if they have problems with their investments, investment accounts, or financial professionals. Highlighting this information may encourage more outreach by investors when they experience such problems, which may increase the likelihood of investors seeking resolution of their or the firm's problems. Further, to the extent investors' awareness of how to report problems is increased, it may have some incremental disciplining effect *ex ante* on financial professionals to the benefit of all retail investors in this market. For example, if retail investors, once aware of how to contact the Commission or FINRA are more likely to do so as a result of the information provided by the relationship summary, firms and financial professionals may improve standards and implement policies and procedures aimed at reducing conduct that would warrant potential outreach to regulators by retail investors.

Finally, this section would state where to find more information about the firm and its financial professionals. Broker-dealers would be required to direct retail investors to additional information about their brokers and services on BrokerCheck, their firm websites (if they have a website; if not, they would state where retail investors can find up-to-date information), and the retail investor's account agreement. Investment advisers likewise would be required to direct retail investors to additional information in the firm's Form ADV Part 2 brochure and any brochure supplement provided by a financial professional to the retail investor. If an adviser has a public website and maintains a current version of its firm brochure on the website, the firm would be required to provide the website address (if an adviser does not have a public website or does not maintain its current brochure on its public website, then the adviser would provide the IAPD website address). Making these links to websites available could be important given that low levels of financial literacy could make it less likely that investors would effectively compile information on their own to use in decision making.

ix. Key Questions To Ask

The proposed relationship summary is expected to benefit retail investors either directly, by providing information about the corresponding firm and financial professional, or indirectly, by encouraging investors to acquire additional information. The relationship summary would also include suggested key questions to encourage retail investors to have conversations with their financial professionals about how the firm's services, fees, conflicts, and disciplinary events affect them.

Under the ''Key Questions To Ask'' heading, firms would be required to include ten questions,[615] as applicable to their particular business, to help retail investors to elicit more information concerning the items discussed in the relationship summary.[616] Given that standardization of disclosures limits personalization that may be valuable to retail investors, the Commission preliminarily believes that the proposed questions would serve an important purpose in the relationship summary—namely, to prompt retail investors to ask their financial professionals for more personalized information.

The proposed list of questions in the relationship summary may alter the actions not only of retail investors but also of firms and their financial professionals. In anticipation of having to answer these key questions, firms may find it in their self-interest to train their staff and develop materials that could help them address the question in greater detail. Such a voluntary response by firms would likely benefit investors to the extent the answers given to the questions may become more informative and more accurate. However, some firms may develop standardized answers in anticipation of the key questions that become less informative to the retail investor than a back and forth conversation.

We believe the proposed set of questions cover a broad range of issues that are likely to be important to retail investors and provide benefits, such as a platform from which to begin a dialogue with their financial professional. However, potential costs may arise for some retail investors. One such potential cost of the proposed questions is that they may anchor the attention of retail investors to the list and reduce the likelihood that they would explore other potential questions that could be important to them based on their unique circumstances.[617] In addition, framing the questions as ''Key Questions'' could lead some retail investors to believe that any other questions they may have due to their own particular circumstances may be of second order importance, even if they may not be.[618]

x. Other Benefits and Costs to Investors

As indicated in the 917 Financial Literacy Study, retail investors consider the proposed disclosures in the relationship summary to be important pieces of information. With respect to content, disclosure items identified as absolutely essential for retail investors were: Adviser's fees (76%), disciplinary history (67%), adviser's conflicts of interest (53%), and adviser's methodology in providing advice (51%). Approximately 54% of investors also believe that disclosures that provided comparative adviser information would be useful. In light of this evidence, the Commission preliminarily believes the disclosure would provide valuable information to retail investors and potentially encourage further information gathering by retail investors that assist them in making an informed choice of what type of account matches their preferences and expectations.[619]

[615] We are proposing to allow firms to modify or omit portions of any of these questions that are not applicable to their business. We are also proposing to require a standalone broker-dealer and a standalone investment adviser, to modify the questions to reflect the type of account they offer to retail investors (*e.g.,* advisory or brokerage account). In addition, we are proposing that firms could include any other frequently asked questions they receive following these questions. Firms would not, however, be permitted to exceed fourteen questions in total. *See supra* Section II.B.8.

[616] *See* proposed Item 8 of Form CRS.

[617] Anchoring is a cognitive bias, whereby receivers of information strongly rely on the initial information received when making decisions, and do not sufficiently adjust to new information received. *See,* Anderson, Jorgen Vitting, *Detecting Anchoring in Financial Markets,* Journal of Behavior Finance 11, 129–133 (2010) *available at https://www.tandfonline.com/doi/abs/10.1080/15427560.2010.483186.*

[618] *See, e.g.,* Tversky Kahneman Article, *supra* note 580, on the importance of framing.

[619] Although the 917 Financial Literacy Study indicated that nearly 90% of survey participants believed that certain disclosures would have been helpful to have in advance of their selection of their current adviser, under the current proposal, firms may and are highly encouraged, though not required, to deliver the relationship summary in

Continued

By providing specified disclosures in an abbreviated and simplified format, the proposed relationship summary could also improve the effectiveness of the communication between investors and investment advisers or broker-dealers. A more effective communication may enable retail investors to more quickly reach an understanding of what type of firm and financial professional or type of account offered by the broker-dealer or the investment adviser best matches their preferences. As a result, search costs may be reduced as retail investors may need to contact fewer broker-dealers or investment advisers and financial professionals given that they have access to information about those firms or financial professionals.[620] The inclusion of key questions as part of the relationship summary also could serve to reduce search costs as well as the potential for mismatched expectations borne by retail investors if such questions foster greater discussion about the services, costs and fees, and possible conflicts associated with broker-dealer and investment adviser business models.

The Commission preliminarily believes that the proposed relationship summary could benefit not only the existing and prospective customers and clients of broker-dealers and investment advisers but also the public more broadly. First, recipients of the relationship summary, to the extent they discuss investing in general, may discuss the topics covered in the summary with family and friends and in the process increase the degree of public awareness about the issues discussed in the disclosure. Second, some prospective retail investors could access the relationship summary independently through the company website or the Commission's website.

The proposed relationship summary may also impose some additional costs on retail investors. As described more fully in the section that follows, brokers-dealers and investment advisers will bear compliance costs associated with the production and dissemination of the relationship summary. As a result of such increased costs, some firms or financial professionals may transfer retail investors from potentially lower cost transaction-based accounts to higher cost asset-based fee advisory accounts, if the firm or the financial professional is dually registered.

In addition to these compliance burdens which may indirectly be borne by retail investors, the disclosures themselves may impose certain indirect costs on retail investors. For example, since the proposed disclosures in the relationship summary are general and contain prescribed language in many parts, they could steer retail investor attention away from some specific and potentially important characteristics of the business practices of the firm or the financial professional. This potential cost is likely to be mitigated to the extent the required Additional Information section employs layered disclosure and the Key Questions encourage more personalized information gathering on part of the retail investors.

b. Broker-Dealers and Investment Advisers

The proposed disclosure requirements would impose direct costs on broker-dealers and investment advisers, including costs associated with delivery, filing, preparation, and firm-wide implementation of the relationship summary, as well as training and monitoring for compliance.[621]

With respect to initial delivery, the relationship summary would need to be provided to retail investors[622] in the case of an investment adviser, before or at the time the firm enters into an advisory agreement or, in the case of a broker-dealer, before or at the time the retail investor first engages the firm's services. A dual registrant should deliver the relationship summary at the earlier of entering into an investment advisory agreement with the retail investor or the retail investor engaging the firm's services. Firms would be permitted to deliver the relationship summary (including updates) electronically, consistent with prior Commission guidance.[623] Firms would also be required to post their relationship summaries on their websites in a way that is easy for retail investors to find, if they maintain a public website. Firms that do not maintain a website would be required to include in their relationship summaries a toll-free number for investors to call to obtain documents. In addition, firms would be required to provide a relationship summary to an existing client or customer who is a retail investor before or at the time a new account is opened or changes are made to the retail investor's account(s) that would materially change the nature and scope of the firm's relationship with the retail investor. Firms also would be required to implement a one-time delivery of the relationship summary to all existing retail investors within 30 days after the date the firm is first required to file its relationship summary with the Commission.[624]

Regardless of the method of delivery (*e.g.,* paper or electronic delivery) firms would incur costs associated with delivering the relationship summary to retail investors. Such flexibility in the method of delivery, while being consistent with Commission guidance, could increase efficiency by allowing a firm to communicate with retail investors in the same medium by which it typically communicates other information. Further, firms could reduce costs by utilizing technologies to deliver information to retail investors at lower costs than they may face with paper delivery.[625] While we recognize that some firms are likely to use electronic delivery methods, and that these methods may be lower cost than paper delivery, some firms may still produce paper versions of the relationship

advance of the time a retail investor enters into an advisory contract with an investment adviser or engages the services of a broker-dealer. Firms would be required to file the relationship summary with the Commission and the disclosure would be made available on public websites of broker-dealers and investment advisers, which indicates that prospective investors could have access to a given firm's relationship summary in advance of initial contact with the firm or its financial professionals. In general, however, the Commission preliminarily anticipates that most prospective retail investors would receive the relationship summary at the time that they meet with a financial professional to consider entering into an agreement or engaging services.

[620] Insofar as retail customers may also search for other providers of financial advice, such as insurance companies or banks and trust companies, the reduction in search costs obtainable from the relationship summary would be lower.

[621] *See infra* Section V.A. for estimates of some of these compliance costs for purposes of the Paperwork Reduction Act.

[622] In addition to the firm's delivery requirements, firms would also file their relationship summary with the Commission, to be publicly available. *See supra* Section II.C.1.

[623] *See supra* Section II.C.2.

[624] Currently, investment advisers have approximately 29 million non-high net worth individual clients and 5 million high net worth individual clients, and the total number of individual clients of investment advisers has increased by 10 million since 2012. Therefore, investment advisers would need to deliver relationship summaries to approximately 35 million existing retail clients, and on average, would expect approximately 2.5 million new clients per year. Item 5.D of Form ADV. Although the Commission is unable to estimate the number of broker-dealer retail customers, we could assume that the number of relationship summaries for broker-dealer customers would be at least as many, if not more, than what would have to be delivered for investment advisers.

[625] Firms would be required to create and maintain records of deliveries of the relationship summary. *See supra* Section II.E. *See supra* Section II.E (discussing recordkeeping requirements relating to the relationship summary). If choosing electronic delivery, firms would have compliance costs in providing notice to retail investors that the relationship summary would be available electronically. *See supra* Section II.C.2 (discussing elements of Commission guidance about electronic delivery of certain documents).

summary, particularly if they have some retail investors that prefer delivery of disclosure in this method, or do not have access to the Internet, or if firms are delivering the relationship summary in the same format alongside other deliverables, such as Form ADV or account statements. Firms would also incur costs of posting the relationship summary on their websites and filing the summary with the Commission.

Beyond costs associated with delivery of the relationship summary to retail investors, firms would be required to prepare the relationship summary. The Commission preliminarily believes, however, that these costs would be limited for several reasons. First, the relationship summary is concise (limited to four pages in length or the equivalent length for electronic disclosure), and would contain a mandated set and sequence of topic areas, with much of the language to be prescribed, thus limiting the time required to prepare the disclosure. Second, the relationship summary will be uniform across retail investors and would not be customized or personalized to potential investors. Finally, the relationship summary would contain some standardized elements across investment advisers and broker-dealers, allowing for potential economies of scale for entities that may have subsidiaries that would also be required to produce the disclosure.

Further to the costs of preparing the relationship summary, we consider the implication of the disclosure requirements attributable to the DOL rules and exemptions, including the DOL's BIC Exemption, and the potential effects of those disclosures relative to the relationship summary for broker-dealers and investment advisers. The conditions of the DOL rules and exemptions, including the BIC Exemption, discussed above in the baseline section, are limited to retirement accounts. Although some firms may have voluntarily adopted disclosure requirements of the BIC Exemption for non-retirement accounts, the proposed relationship summary would apply to a broader array of relationships, spanning both retirement and non-retirement accounts for broker-dealers and investment advisers. To the extent that the information provided by the relationship summary would be duplicative of information that would be required by the BIC Exemption (or other DOL rules and exemptions) and provided to the same group of account holders that would receive the DOL required disclosures, the overall benefits of the relationship summary could be reduced. Lastly, to the extent that some financial firms already have set up procedures and systems to comply with the DOL disclosure requirements, these firms may incur lower incremental compliance burdens. The Commission preliminarily believes, however, that the scope of the disclosure requirements under DOL rules and exemptions and the systems that firms would have put in place to accommodate such disclosures are unlikely to have a significant overlap with the relationship summary. Therefore, the Commission anticipates that any potential cost savings for firms to comply with disclosure obligations under DOL rules and exemptions and the relationship summary are likely to be minimal.

With respect to preparing and implementing the relationship summary, firms would also need to expend resources with respect to the required Key Questions in the relationship summary. Firms would bear costs of preparing responses the questions from the list and training their employees on how to respond. Financial professionals need to spend time to prepare their responses to the questions and to respond to these questions when asked. As a result, some firm employees or financial professionals could take away from the time they dedicate to investigate investment recommendations, which could inadvertently harm investors if financial professionals divert resources to answering key questions but reduce their time devoted to arriving at investment strategies. In this case, the quality of their recommendations could decline. In both cases, the possible additional costs to firms could be (partially) transferred to retail investors.

In addition to the costs associated with preparation, delivery, filing, and posting on websites of the initial relationship summary, firms would also bear costs for updating the relationship summary within 30 days whenever any information becomes materially inaccurate.[626] The firm would be required to communicate updated information to retail investors who are existing customers or clients of the firm within 30 days whenever any information in the relationship summary becomes materially inaccurate.[627] Firms could communicate this information by delivering the amended relationship summary or by communicating the information another way to the retail investor. For example, if an investment adviser communicated a material change to information contained in its relationship summary to a retail investor by delivering an amended Form ADV brochure or Form ADV summary of material changes containing the updated information, this generally would support a reasonable belief that the information had been communicated to the retail investor, and the investment adviser generally would not be required to deliver an updated relationship summary to that retail investor. This requirement provides firms the ability to disclose changes without requiring them to duplicate disclosures and incur additional costs. The updated relationship summary would also need to be posted prominently to the firm's website if the firm has one and filed electronically with the Commission. In addition, firms could also incur some costs to keep records of how the updated relationship summary or the information in the updated relationship summary was delivered to retail investors.

We anticipate that the compliance costs associated with producing updates of the relationship summary would be also relatively minor given that the relationship summary uses largely prescribed language and updates of the relationship summary, which are only required for material changes, are expected to be infrequent. As a result, the costs of such updates are expected to be small relative to the costs associated with the initial production of the disclosure. Further, annual costs associated with communications regarding updates to the relationship summary are anticipated to be lower than the costs of the initial delivery to existing retail investors to the extent the frequency of updates is low or the firm communicates the updates through other ways than formal delivery. The Commission anticipates that some of the costs associated with preparation, delivery, filing, website posting, and updates to the relationship summary for an average broker-dealer or average dual registrant could exceed the costs for the average investment adviser. As Table 1 and Table 3 indicate, broker-dealers maintain a larger number of accounts than investment advisers do; therefore, delivery costs for broker-dealers could exceed those of investment advisers, if the number of accounts is a good indicator of the number of retail

[626] Along this line, firms could also incur some costs of modifying prescribed disclosure per the parameters of Instruction 3.

[627] The requirement to communicate updated information to retail investors, rather than deliver an updated relationship summary could reduce the effectiveness of the information to the extent that the communication does not allow retail investors to see the context in which information was changed.

investor customers.[628] Similarly, given that the average dual registrant has more customer accounts than the average investment adviser, and that the preparation of relationship summaries for dual registrants may require more effort than for standalone broker-dealers or investment advisers, the compliance costs could be larger for these firms.

In addition, unlike investment advisers, which produce Part 2A of Form ADV, a broker-dealer currently is not required to prepare a narrative disclosure document for its retail investors, although under existing antifraud provisions of the Exchange Act, a broker-dealer may be liable if it does not disclose material information to its retail investors. Thus, broker-dealers could expend additional time and effort to aggregate the information required by the relationship summary relative to investment advisers. As a result, the Commission preliminarily believes that the investment advisers should be able to produce the relationship summary at a relatively lower cost than broker-dealers, given investment advisers' experience with preparing and distributing Part 2A of Form ADV.[629]

The Commission preliminary believes that compliance costs would also be different across firms with relatively smaller or larger numbers of retail investors as customers or clients. For example, to the extent that developing the relationship summary entails a fixed cost, firms with a relatively smaller number of retail investors as customers or clients may be at a disadvantage relative to firms with a larger number of such customers or clients since the former would amortize these costs over a smaller retail investor base. Firms with a relatively larger number of existing retail investors would face higher costs of initial distribution of the relationship summary compared to firms with a relatively smaller retail investor base. Further, to the extent that certain costs associated with preparing different versions of the proposed relationship summary scale with the number of branches and associated financial professionals that a firm has, firms with a relatively larger number of branches and employees may bear higher costs than firms with a smaller number.

While the imposed four-page limit is expected to impose nominal compliance costs on market participants, it could also generate additional costs for some firms relative to others. For example, the four-page limit may be more costly for firms that have more complex business models because it will limit the information they can present within the relationship summary.[630] For example, a firm with a disciplinary history that provides exceptionally good customer service could be at a disadvantage compared to other firms with no disciplinary history because the relationship disclosure may not summarize relevant information about the quality of customer service or the full scope of services offered by the firm.

Based on the estimates provided in Section V.A for Paperwork Reduction Act purposes, the average cost burden for an investment adviser to prepare the proposed Form CRS for the first time is estimated to range between approximately $1,300 and $3,400, depending on the extent to which external help is used.[631] The estimated aggregate combined internal and external costs to investment advisers industry-wide for initially preparing and filing the relationship summary would be approximately $22 million.[632] Similarly, for broker-dealers, the average cost to a firm for preparing Form CRS for the first time is estimated to range between approximately $4,000 and $6,100, based on the estimate provided in Section V.D.[633] The estimated aggregate combined internal and external costs to broker-dealers industry-wide of initially preparing and filing the relationship summary would be approximately $15 million.[634] In terms of the initial cost of delivering the relationship summary to current retail investors, we estimate that the cost to existing and newly registered investment advisers would be approximately $43.4 million in aggregate, or approximately $5,350 per adviser.[635] For broker-dealers, the estimated initial cost of delivering the relationship summary to current retail investors would be approximately $121.5 million in aggregate, or approximately $42,500 per broker-dealer.[636] For both investment advisers and broker-dealers, the estimated annual costs of the requirement to deliver the relationship summary before or at the time a new account is opened, or changes are made to the retail investor's account(s) that would materially change the nature and scope of the firm's relationship with the retail investor, is approximately 10% of the respective estimated costs of the initial delivery to existing retail investors.[637]

Finally, the Commission believes that the proposed relationship summary would bring tangible benefits to many broker-dealers and investment advisers. Although the possibility of mismatched expectations for retail investors and their choice of financial firm or professional generally are most costly to the retail investors, such mismatch also imposes costs on broker-dealers and investment advisers. For instance, some investors who have mismatched their

[628] The Commission is unable to obtain from Form BD or FOCUS data information on broker-dealer numbers of customers, and instead, is only provided with the number of customer accounts. The number of customer accounts will exceed the number of customers as a customer could have multiple accounts at the same broker-dealer.

[629] For example, investment advisers may already have specialized staff dealing with disclosure issues.

[630] Complexity is not necessarily linked to size—for example, there are large, simple firms and small, complex firms.

[631] The lower end estimate is based on the assessment that, without additional external help, it will take an average investment adviser 5 hours to prepare the relationship summary for the first time, *see infra* Section V.A.2.a. We assume that performance of this function will be equally allocated between a senior compliance examiner and a compliance manager at a cost of $229 and $298 per hour, (*see infra* note 743 for how we arrived at these costs). Thus, the cost for one investment adviser to produce the relationship summary for the first time is estimated at $1,317 (2.5 hours × $229 + 2.5 hours × $298 = $1,317) if no external help is needed. In addition, we estimate that if the investment adviser needs external help, the average cost to an investment adviser for the most expensive type of such help (*i.e.,* compliance consulting services) would be $2,109, *see infra* note 732, which brings the total cost to $3,426.

[632] *See infra* Sections V.A.2.a and V.A.2.b for estimates of aggregate internal and external costs, respectively, of the initial preparation and filing of the relationship summary.

[633] The lower end estimate is based on the assessment that, without additional external help, it will take an average broker-dealer 15 hours to prepare the relationship summary for the first time, *see infra* Section V.D.2.a. We assume that performance of this function will be equally allocated between a senior compliance examiner and compliance manager at a cost of $229 and $298 per hour, respectively (*see infra* note 743 for how we arrived at these costs). Thus, the cost for one broker-dealer to produce the relationship summary for the first time is estimated a $3,953 (7.5 hours × $229 + 7.5 hours × $298 = $3,953) if no external help is needed. In addition, we estimate that if the broker-dealer needs external help, the average cost to a broker-dealer for the most expensive type of such help (*i.e.,* compliance consulting services) would be $2,109, see infra note 826, which brings the total cost to $6,062.

[634] *See infr*a Sections V.D.2.a and V.D.2.b for estimates of aggregate internal and external costs, respectively, of the initial preparation and filing of the relationship summary.

[635] *See infra* Section V.C.2.b.i for the estimate of costs investment advisers would incur to deliver the relationship summary to their existing clients. Note that the analysis includes investment advisers that are dual registrants.

[636] *See infra* Section V.D.2.d.i for the estimate of costs investment advisers would incur to deliver the relationship summary to their existing clients. Note that thee analysis includes broker-dealers that are dual registrants.

[637] *See infra* Section V.C.2.b.ii for the estimate of these costs for investment advisers and *infra* Section V.D.2.d.ii for the analysis of these costs for broker-dealers.

expectations of a financial services provider with the type of provider they have engaged may lodge complaints with the SEC or FINRA for perceived misconduct by their financial professional without understanding the nature of their relationship (*e.g.,* an investor may file a complaint of discretionary trading in an investment advisory account because they did not understand the nature of the services for which they contracted). These complaints are costly to firms and financial professionals, and the Commission preliminarily believes that the relationship summary could alleviate search costs for investors and the likelihood of mismatch between investor expectations and their choice of firm or financial professional.

With respect to particular elements of the relationship summary, firms with relatively no currently reportable legal and disciplinary disclosures could benefit directly from the reporting in the relationship summary because the reporting would make these characteristics more salient for retail investors by prompting investors to research disciplinary history of firms with currently reportable legal and disciplinary disclosures. To the extent that including disciplinary history information in the relationship summary increases the propensity of retail investors to consider this information when selecting firms and financial professionals, it could also ultimately increase the cost of misconduct for firms and financial professionals (for example, by making it more difficult to attract retail investors), which would make it more likely that firms take disciplinary information into account when making employment choices, thereby potentially raising the overall quality of their workforce. The relationship summary could further exhibit some positive long-term effects on the markets for broker-dealers and investment advisers and we elaborate on these long-term effects in greater detail in the next subsection.

3. Impact on Efficiency, Competition, and Capital Formation

In addition to the specific benefits and costs discussed in the previous section, the Commission expects that the proposed disclosure could cause some broader long-term effects on the market for financial advice. Below, we elaborate on these possible effects, including a discussion of their impact on efficiency, competition, and capital formation.

The primary long-term effect of the disclosure on the market is that it could enhance the competitiveness of the broker-dealer and investment adviser markets. The increased transparency with respect to the nature of the relationship between broker-dealers or investment advisers and their retail investors may allow retail investors to better evaluate their firms and financial professionals as well as the options for financial services that are advertised by them, which may increase the overall level of retail investor understanding in the market. When retail investor understanding increases, the degree of competitiveness of the financial services industry may also increase because retail investors could better assess the types of services available in the market. Market competitiveness could be further enhanced by the fact that, by prompting investors to understand better and obtain more information on the services provided as well as the types of fees and costs associated with such services, the relationship summary may reduce search costs for retail investors associated with acquiring this information, thus allowing them to more readily identify less expensive services that match their preferences and expectations for financial services. The relationship summary also could cause additional competition around conflicts of interest, resulting in some firms changing their practices to decrease conflicts. Proposed Regulation Best Interest also requires broker-dealers to disclose all material facts relating to the scope and terms of the relationship, and all material conflicts of interest associated with the recommendation.[638] The Commission preliminarily believes that the relationship summary, which draws investor awareness to potential conflicts of interest at the outset of the relationship with a firm or financial professional, would address similar concerns related to the material facts associated with the scope and terms of the relationship as required by proposed Regulation Best Interest. Relative to the disclosures required by proposed Regulation Best Interest, the relationship summary conflicts of interest disclosures apply not only to broker-dealers and dually-registered firms, but also to investment advisers.

Increased competitiveness in the market for financial services could have ancillary effects as well, including reduced pricing power for firms and incentives for firms to innovate products and services. Reduced pricing power, as a result of increased competitiveness, could benefit retail investors through lower fees, effectively redistributing value from holders of financial firm equity to their retail investors.[639] We note, however, that this effect could be mitigated by the possibility that people may still be willing to pay higher prices for other reasons, including firm reputation. Competition also provides incentives for firms to develop and innovate. Additional competition among financial services firms could provide incentives for broker-dealers and investment advisers to seek alternative ways to generate profits. In the process, firms could develop new and better ways of providing services to retail investors, for example, by utilizing recent developments in information technologies to deliver information to retail investors at lower cost. In this way, innovation could thus improve the satisfaction of retail investors and the profitability of firms in the financial services provider market.

Another potential positive effect of the relationship summary is that, by reporting whether a firm or financial professional has currently reportable legal or disciplinary events, the relationship summary could prompt retail investors to seek out disciplinary information on their current and prospective firms and financial professionals and take that information into account when considering whom to engage for financial services. In this respect, the proposed relationship summary may also enhance competition if, for example, firms and financial professionals with better disciplinary records outcompete those with worse records. We note, however, that reporting whether a firm or financial professional has currently reportable legal or disciplinary events may also bias firms toward hiring firms or financial professionals with fewer years of experience (*i.e.,* fewer opportunities for customer complaints) and against hiring experienced financial professionals with some (minor) customer complaints. The expected economic impact of the above effect across small and large firms, however, is generally unclear. For investment advisers and broker-dealers, reportable disciplinary events are less common for smaller firms than for larger firms.[640]

[638] Further, proposed Regulation Best Interest would establish policies and procedures to identify and at a minimum disclose or mitigate material conflicts of interest associated with such recommendations, as well as policies and procedures to identify, disclose and mitigate or eliminate material conflicts of interest arising from financial incentives associated with such recommendations.

[639] *See* Jean Tirole, *The Theory Of Industrial Organization,* M.I.T. Press (1989).

[640] For example, while only 10% of registered investment advisers with less than $1 million of

Continued

However, in the market for financial services between investment advisers and broker-dealers, disclosing the existence of currently reportable legal and disciplinary events in the relationship summary may confer a small competitive advantage for investment advisers because broker-dealers are more likely to have to report that they have a disciplinary history due to broader broker-dealer disclosure obligations.[641] They are also more likely to report if they have more disciplinary issues. Reporting from Form BD with respect to broker-dealer disclosures of disciplinary actions taken by any regulatory agency or SRO shows that 308 (84%) out of 366 dual-registered broker-dealers disclosed a disciplinary action. By contrast, 1,650 (47%) out of 3,475 standalone broker-dealers have a disclosed disciplinary action. For investment advisers, Form ADV requires disclosures of any disciplinary actions taken in the past ten years. 289 (79%) out of 366 dual-registered investment advisers disclosed a disciplinary action. A much lower fraction, 1,732 (14%) of 12,293, standalone investment advisers disclosed a disciplinary action.[642] The fact that broker-dealers have relatively more reportable legal and disciplinary events than investment advisers may cause retail investors to engage investment advisers rather than broker-dealers, thus creating a competitive advantage for some investment advisers.

Although the proposed relationship summary applies to SEC-registered broker-dealers and SEC-registered investment advisers, it could exhibit some spillover effects for other categories of firms not affected by the proposal such as investment advisers not registered with the SEC, bank trust departments, and others. In particular, the relationship summary could change the size of the broker-dealer and investment adviser markets—relative to each other, as well as relative to other markets. To the extent the relationship summary reduces retail investors' confusion and makes it easier for them to choose a relationship in line with their preferences and expectations, the Commission expects that this could attract new retail investors to these markets, coming from firms in other markets. Firms' current retail investors also may consider switching to a different type of firm if the relationship summary makes the different services provided and the fees and costs of investment advisory and brokerage services more prominent. The exact extent and direction of substitution between brokerage and advisory services is hard to predict and depends on the nature of the current mismatch between retail investor preferences and expectations and the type of services for which they have contracted.

The proposed relationship summary may also benefit financial markets more broadly. Recent survey evidence suggests that 60% of all American households have sought advice from a financial professional.[643] Despite their prevalence and importance, however, financial professionals are often perceived as dishonest and consistently rank among the least trustworthy professionals.[644] This perception has been partly shaped by highly publicized scandals that have affected the industry over the past decade. Systematic mistrust may suppress household stock market participation below the optimal threshold predicted by academic investment theory, as documented in household survey based studies.[645] The Commission preliminarily believes that the increased transparency of the existing business practices of financial professionals could raise the level of investor trust in the market. The enhanced trust could promote retail investor participation in capital markets which could increase the availability of funds for businesses. Depending on the magnitude of the effect, greater availability of funds could lower firms' cost of capital, allowing firms to accumulate more capital over time.

We note a possible negative effect on the trust of some retail investors due to the disclosure on the relationship summary that a firm or financial professional has currently reportable legal or disciplinary events. The decrease in the trust levels of some retail investors, however, could also benefit these investors by bringing their expectations and perceptions in line with their choice of a firm or financial professional.[646]

Another possible long-term effect of the relationship summary is that it could decrease the prevalence of third-party selling concessions in the market by requiring broker-dealers and dual registrants to include prescribed disclosure about indirect fees associated with investments that compensate the broker-dealer, including mutual fund loads. Currently, selling concessions constitute a significant part of the compensation of broker-dealers selling mutual fund products.[647] For example, a mutual fund may provide a selling concession, in the form of a sales charge, some portion of which could be remitted to the broker-dealer that recommended the product.

Table 2, Panel A also indicates that selling concessions constitute a larger fraction of total revenue (commissions, fees, and sales of IC shares) for smaller broker-dealers—for example, selling concessions as a fraction of revenues represent around 20% for broker-dealers with total assets less than $1 million and less than 4% for broker-dealers with total assets in excess of $50 billion. To compensate for the potential loss of concession-based revenue, broker-dealers could try to switch customers to advisory accounts. As noted above, however, if the proposed disclosure also increases the competitiveness in the broker-dealer and investment adviser markets the increased competitiveness would create some downward price pressure in the market.

AUM disclose at least one disciplinary action as of January 1, 2018, 66% of registered investment advisers with more than $50 billion of AUM disclosed at least one disciplinary action that year. Form ADV. Similarly, while 89% of broker-dealers with less than $1 million in total assets disclose at least one disciplinary action as of January 1, 2018, 100% of broker-dealers with more than $50 billion total assets disclosed at least one disciplinary action that year. Form BD.

[641] *See supra* notes 251, 253—255 and accompanying text.

[642] Source: Items 11C, 11D, and 11E of Form BD and Items 11.C., 11.D. and 11.E. of Form ADV. Form BD asks if the SEC, CFTC, other federal, state, or foreign regulatory agency, or a self-regulatory organization have ever found the applicant broker-dealer or control affiliate to have (1) made a false statement or omission, (2) been involved in a violation of its regulations or statues, (3) been a cause of an investment related business having its authorization to do business denied, suspended, revoked, or restricted, or (4) imposed a civil money penalty or cease and desist order against the applicant or control affiliate. Likewise, Form ADV asks similar questions of registered investment advisers and advisory affiliates.

[643] *See supra* note 541. Survey of Consumer Finances, 2016. The percentage aggregates all respondents indicating that they use at least one of the following sources in making saving and investment decisions—brokers, financial planners, accountants, lawyers, or bankers. 26% of the respondents indicate that they have used brokers or financial planners.

[644] *See* Edelman Trust Barometer, *2015 Edleman Trust Barometer Executive Summary* (2015), *available at https://www.edelman.com/2015-edelman-trust-barometer/*; Anna Prior, *Brokers are Trusted Less than Uber Drivers, Survey Finds,* Wall Street Journal (Jul. 28, 2015), *available at https://www.wsj.com/articles/brokers-are-trusted-less-than-uber-drivers-survey-finds-1438081201*; Luigi Zingales, *Does Finance Benefit Society,* Journal of Finance 70, 1327–1363 (Jan. 2015).

[645] *See, e.g.,* Luigi Guiso, Paola Sapienza & Luigi Zingales, *Trusting in the Stock Market,* The Journal of Finance, Vol. 63, No. 6, 2557–2600 (2012); and J. Campbell, *Household Finance,* The Journal of Finance, Vol. 61, No. 4, 1553–1604 (2006) (''Campbell Article'').

[646] *See* Jeremy Ko, *Economics Note: Investor Confidence* (Oct. 2017), *available at https://www.sec.gov/files/investor_confidence_noteOct2017.pdf.*

[647] *See supra* Table 2, Section IV.A.1.a.

4. Alternatives to the Proposed Relationship Summary

This section highlights alternatives to the relationship summary concerning an amendment of existing Forms BD and ADV for broker-dealers and investment advisers, respectively; the form and format of the relationship summary; extensiveness of disclosure; delivery; and communicating information about the updated relationship summary.

a. Amendment to Existing Disclosures

As proposed, the relationship summary would be a new, standalone disclosure produced by broker-dealers and investment advisers, in addition to the other required information disclosed by broker-dealers and investment advisers. As an alternative, the Commission could consider incorporating the relationship summary information into existing disclosures.

For example, Part 2A of Form ADV currently has 18 mandatory reporting elements, produced as a narrative discussion, as part of the disclosure ''brochure'' provided to prospective retail investors initially and to existing retail investors annually. Instead of requiring investment advisers to produce a completely new disclosure as a separate Form CRS, the Commission could instead make an amendment to Part 2A of Form ADV to require a brief summary at the beginning of the brochure in addition to the existing narrative elements, or to change certain of the disclosure requirements to reduce or eliminate redundancy. Similarly, broker-dealers could be required to deliver longer narrative disclosure to their retail investors with specified elements. Such disclosure could also be required as part of Form BD or a standalone requirement.[648] For example, the instructions to Form BD contain a section on the explanation of terms which could be extended to include basic (registrant-specific) information on the business practices of the registrant.

Although modifying existing disclosure and reporting in these ways could provide the same information to retail investors as the proposed relationship summary, the Commission believes that these approaches would be less suited for the objective of this disclosure, which is to provide a short, simple overview. The proposed relationship summary would provide disclosure in a standardized, simplified manner, that would allow retail investors not only to compare information within a category (*e.g.,* two investment advisers), but also across categories (*e.g.,* investment advisers and broker-dealers). Further, the relationship summary would be designed to be easily comprehensible by retail investors, relying on short, easy-to-read disclosure that would provide an overview of information about the firm and its financial professionals to retail investors when choosing a firm and account type. We believe that the proposed relationship summary would benefit retail investors by highlighting succinct information that is relevant to a decision to select a firm, financial professional, or account type and services, at the time such decisions are made, and relying on layered disclosure to provide additional detail.

b. Form and Format of the Relationship Summary

The Commission is proposing to require broker-dealers and investment advisers to create and deliver a short relationship summary to retail investors that would highlight specified information under prescribed headings in the same order to facilitate comparability. The relationship summary would be limited in length and would contain a mix of prescribed and firm-specific language. The proposal does not specify a single format for filing the disclosure.

The Commission could require the relationship summary be filed with the Commission in a specified format, such as an text-searchable PDF file or in some other format, for example, an unstructured PDF or HTML, structured PDF, a web-fillable form, XML, XBRL or Inline XBRL. Further to this alternative, the Commission could require that the relationship summary information be filed in a structured format to facilitate validation, aggregation and comparison of disclosures, and the Commission could then make the data available on IARD and EDGAR. Structured format, such as XML, can enable the automatic generation of unstructured formats such as PDF, HTML, and others to meet the needs of those users who would prefer a paper-oriented layout.

As an alternative to the largely prescribed language for the relationship summaries, the Commission could instead allow broker-dealers and investment advisers to construct bespoke disclosure, while providing guidance to firms on the elements of the relationship disclosure that are required to be included. Although this disclosure would allow firms to tailor the discussion of the nature of the business, fees and costs, conflicts of interest, and disciplinary history specifically to their business model, this approach would likely be more costly to retail investors, as it would likely diminish the usefulness of a concise, simplified disclosure that is capable of being used by retail investors to understand firm types. Longer firm-specific disclosures could also increase the search costs for retail investors which could ultimately result in worse choices by lowering investor ability and incentives to screen a large number of firms. Higher search costs for investors could also lower the competitiveness of the market by allowing some firms with lower-quality services to maintain customers and sustain market share, even if better choices are available to retail investors. As discussed above in Section III.B, simplification of disclosures, in terms of size, presentation, and readability, allows for ease of processing of information, while standardization of the content would facilitate identification of information most useful to a retail investor. Finally, lengthier bespoke disclosure would be also costlier for firms to produce. As another alternative, the Commission could have required the relationship summaries to include only prescribed wording. However, the Commission believes that a mix of prescribed and firm-drafted language provides both information that is useful for retail investors in comparing different firms along with some flexibility for firms to determine how best to communicate the information about their particular practices to retail investors.

c. Extensiveness of Disclosure

As currently proposed, the relationship summary would include high-level information on (i) introduction; (ii) the relationships and services provided in the firm's advisory accounts and brokerage accounts; (iii) the standard of conduct applicable to those services; (iv) the fees and costs that retail investors will pay, (v) comparison to other account types; (vi) specified conflicts of interest; (vii) where to find additional information, including whether the firm and its financial professionals currently have reportable legal or disciplinary events and who to contact about complaints; and (viii) key questions for retail investors to ask the firm's financial professional. As an alternative, the Commission could require the inclusion of additional topics or additional disclosures on one or more topics proposed to be covered by the relationship summary. These disclosures could be required as part of the relationship summary or as separate appendices.

[648] We note, however, that Form BD is a registration/application form (rather than an existing brochure-type disclosure form).

With respect to the additional topics to be disclosed, the Commission could request that firms disclose additional information on their performance, investment style, or other business practices. Retail investors, however, may become overwhelmed if presented with a number of very lengthy disclosures, which therefore could bury the information that is most useful to investors and reduce the effectiveness of those disclosures.[649] With respect to the specific topics of additional information, evaluating the performance, investment style and business practices of a firm or financial could be subjective or speculative, and may be more suited for marketing materials rather than prescribed language in the relationship summary.[650] For all these reasons, we believe that these additional disclosure topics are not appropriate for inclusion in the relationship summary.

Regarding alternatives to the disclosure of fees and costs as proposed here, the relationship summary could require additional disclosures on one or more of these topics. For example, the relationship summary could include the firm's fee schedule, either as part of the body of the relationship summary or as an attachment. Alternatively, we could require each relationship summary to include a personalized fee schedule,[651] to be created for each retail investor, detailing the specific fees and costs associated with the retail investor's account, presented both in dollars and as a percentage of the value of the retail investor's account. These fee schedules could also include compensation received by the firm and its financial professionals related to the account, and the indirect fees that are payable by the retail investor to others (*e.g.,* mutual fund and exchange-traded fund fees and expenses). However, ex ante identifying possible fee schedules for investors at the outset of a relationship as opposed to at the time of the transaction could impose costs to both investors and firms. For example, firms might need to outline a long list of possible transactions and the associated fee schedules, which in turn could be confusing to investors.

We could also require more comprehensive disclosures regarding conflicts of interest and disciplinary history, including requiring firms to summarize more or all of their conflicts of interest.[652] For example, firms could disclose potential conflicts of interest associated with execution services, such as those required to be reported in rule 606 disclosures.[653]

We could also require additional details about a firms' and its financial professionals' disciplinary history. Instead of requiring firms to disclose whether or not they have currently reportable legal or disciplinary history, as proposed, we could require firms to disclose the number of disciplinary events, expressed as a number or as a percentage of the size of the firm or the number of firm professionals. We could further differentiate the disclosures by requiring firms to disclose the existence and numbers of disciplinary histories within categories of disciplinary history.

More detailed disclosures about fees, compensation, conflicts and disciplinary history could help retail investors understand better the differences between types of accounts, and could facilitate the decision about the most appropriate account for each retail investor. As noted above, current disclosures on these topics cover only subsets of firms and relationships and could take different forms. For example, firms wishing to make investment recommendations to IRAs and participants of ERISA-covered plans may be subject to certain disclosure obligations.[654] This disclosure, however, does not apply to non-retirement accounts. Investment advisers also prepare a Form ADV Part 2A narrative brochure but such a retail disclosure document is not currently required for broker-dealers. As a result, the Commission preliminary believes that retail investors could benefit from the proposed relationship summary given its wide coverage, delivery method, and design.

In particular, the disclosures about types of fees and costs included in the relationship summary could help retail investors understand better the types of fees that they will pay and how those types of fees and costs affect their accounts. As discussed in the baseline, the 917 Financial Literacy Study highlighted that transparency and disclosure about fees charged by financial intermediaries was one of the most essential elements that investors would consider in making their decision about which financial professional to choose.[655]

Similarly, the information provided about conflicts of interest in the relationship summary could help retail investors understand how such conflicts that might be pertinent to their account. The disclosure about whether the firm or financial professional has currently reportable legal or disciplinary events could encourage retail investors to research the extensiveness and nature of the disciplinary history of a firm, therefore allowing retail investors to further evaluate firms based on the types of disciplinary events.

Although additional disclosures on account types, fees and compensation (including a fee/compensation schedule), conflicts of interest and disciplinary history could enhance retail investors' understanding of the accounts that are available to them, there are a number of additional costs associated with these alternatives. As noted earlier in the release, extensive empirical evidence suggests that as documents get lengthier and more complex, readers either stop reading or read less carefully.[656] Retail investors, therefore, may become overwhelmed if presented with lengthy disclosure, which could bury the information that is most important to investors and reduce the effectiveness of those disclosures.[657] Further, the compliance and production costs of additional disclosure would increase significantly the overall compliance costs to broker-dealers and registered investment advisers.

As another alternative, the Commission could require a shorter relationship summary, limited to one page (or equivalent limit for electronic format) that would highlight important topics for retail investors and/or including only key questions for retail investors to ask. This alternative relationship summary would be highly readable, with prescribed formatting,

[649] *See also supra* note 50 and accompanying text (discussing comment letters to the 917 Financial Literacy Study regarding the length of disclosure documents).

[650] In terms of performance, studies have shown that investors take into account information about historic fund performance in their investment choice; *see, e.g.,* Choi Laibson Article, *supra* note 567.

[651] One requirement of proposed Regulation Best Interest would be to provide to investors at the time of or prior to a recommendation the expected fees and costs, and possibly a fee schedule, associated with the individual transaction.

[652] *See supra* Section II.B.6 for a discussion of conflicts, or specific details of conflicts, that would not be required to be disclosed in the proposed Form CRS.

[653] *See* 17 CFR 242.606 (requiring that broker-dealers make publicly available a quarterly report on order routing information, including a discussion of the material aspects of their relationship with venues executing non-directed orders, including arrangements for payment for order flow and any profit-sharing arrangement).

[654] *See supra* Section IV.A.1.c (discussing disclosure obligations under DOL rules and exemptions).

[655] *See supra* note 20.

[656] *See, e.g.,* 917 Financial Literacy Study, *supra* note 20.

[657] *See also supra* note 50 and accompanying text (discussing comment letters to the 917 Financial Literacy Study regarding the length of disclosure documents).

and could highlight the differences between brokerage and advisory services and fees, and flag for retail investors the existence of firms' and financial professionals' conflicts of interest without discussing any specific conflicts. However, the one-page relationship summary would be the same or very similar across firms, and therefore likely would not facilitate detailed comparison across firms or provide enough information to highlight the differences for most retail investors.

We alternatively could require firms to create separate relationship summaries for each account type they offer to retail investors, and require firms to provide a retail investor only the relationship summary for the service being offered.[658] This would result in more detailed disclosures on specific account types, and would potentially provide retail investors with more relevant information about account types that they are interested in reviewing (and less extraneous information about account types that they are not interested in reviewing). However, providing such focused relationship summaries could decrease comparability across account types, as the relationship summary would not present, in one place, the differences in accounts and services offered.[659] In addition, this would result in more costs to firms with multiple advisory and brokerage services, as they would be required to prepare several relationship summaries, although they may also have the resources to do this. The Commission preliminarily believes that, as a tool for layered disclosure, the relationship summary as proposed facilitates retail investors' ability to obtain more detailed disclosures on account types by encouraging retail investors to ask questions and request more information.

d. Delivery

As currently proposed, firms would be required to deliver the relationship summary before or at the time an investment adviser enters into an advisory agreement with a retail investor, or, for broker-dealers, before or at the time the retail investor first engages the firm's services. Dual registrants would be required to deliver the relationship summary at the earlier of entering into an investment advisory agreement with a retail investor or the retail investor engaging the firm's services. As with other disclosure, a firm would be permitted to deliver the relationship summary (including updates) electronically, consistent with the Commission's guidance regarding electronic delivery. In addition, firms would be required to implement a one-time delivery of the relationship summary to existing retail investors as a transition requirement. We are also proposing a requirement for firms to post their relationship summaries on their websites in a way that is easy for retail investors to find, if they maintain a public website. Firms that do not maintain a website would be required to include in their relationship summaries a toll-free number for investors to call to obtain documents.

In addition, a firm would be required to provide a relationship summary to an existing client or customer who is a retail investor before or at the time a new account is opened or changes are made to the retail investor's account(s) that would materially change the nature and scope of the firm's relationship with the retail investor, as described in more detail in Section III.C.2 above. A firm would also be required to deliver the relationship summary to a retail investor within 30 days upon request. Furthermore, firms would be required to file current relationship summaries with the Commission, which would be made publicly available, and would be required to post a current version of their relationship summary on their website, if they maintain one.

As an alternative regarding delivery, the Commission could require that the relationship summary would only be available through electronic delivery, such as an email attachment, an email with the full text of the relationship summary in the body of the text, or an email with a hyperlink to the firm's website. Although alternatives relying exclusively on electronic delivery could reduce costs associated with the production of those disclosures, the proposed approach would give the potential benefits of providing information to retail investors in a timely fashion in order to help retail investors select a financial professional or firm, while recognizing the proliferation of the various means of communications, electronic or otherwise, available to firms and retail investors. Our approach also recognizes that some retail investors may not have Internet access or may prefer delivery in paper.

The Commission could have also eliminated the requirement for firms to post the relationship summary on their websites and file the disclosure with the Commission. However, we believe that the relatively minimal cost to firms for posting and filing is outweighed by the benefit of providing easily accessible information to retail investors to assist them in deciding among firms and financial professionals.

Another possibility would have been also not to require a one-time delivery of the relationship summary to existing retail investors. The Commission believes that since the information in the relationship summary is potentially valuable to new investors it would be also potentially valuable for the existing customers of broker-dealers and investment advisers. While existing retail investors would face higher costs to change from an existing financial services provider to a new one than new potential investors would, most existing investors would be still able to reevaluate their relationships with their current firm and investment professionals. Furthermore, there is an inherent cost to retail investors when the services they receive do not meet their expectations. To the extent delivery of the relationship summary to existing retail investors fosters greater understanding and decreases the mismatch, this could mitigate any costs of changing financial service providers. Distributing the relationship summary to a larger group of initial investors further increases the group of individuals that could become familiar with the disclosure indirectly through interactions with family and friends.

As another alternative, the Commission could have proposed only a delivery requirement for the relationship summary, like Form ADV Part 2B, instead of also requiring that firms file it with the Commission. As discussed also in Section III.A above, although not requiring the summaries to be filed with the Commission could reduce the costs to firms for preparing the document to be filed, the Commission believes that public access to relationship summaries benefits prospective retail investors by allowing them to compare firms when deciding whether to engage a particular firm or financial professional or open an advisory or brokerage account, particularly if the summaries can be located on a single point of access. Further, filing the relationship summary with the Commission provides public access regardless of whether a particular firm has a website with which to provide public access to the disclosure.

[658] *See* Comment letter of Fidelity responding to FINRA's Regulatory Notice 10–54 (Dec. 27, 2010), *available at http://www.finra.org/sites/default/files/NoticeComment/p122723.pdf.*

[659] We note that firms with multiple account types within brokerage or advisory would not have the flexibility to describe/distinguish the different account types (*e.g.,* a brokerage firm that offers a range of accounts—from completely self-directed to mutual-fund only to full-service).

e. Communicating Updated Information

As currently proposed, firms would need to update their relationship summary within 30 days whenever any information in the relationship summary becomes materially inaccurate. Our proposal would also require firms to communicate the information in the amended relationship summary to retail investors who are existing clients or customers of the firm within 30 days after the updates are required to be made and without charge. The communication can be made by delivering the relationship summary or by communicating the information in another way to the retail investor.[660] Each firm would also be required to post the updated relationship summary prominently on its website (if it has one) and electronically file the current version of the summary with the Commission.

Alternatively, the Commission could require that the relationship summary also be updated and delivered annually, which would be similar to the current requirements for investment advisers to provide an updated ''brochure'' derived from Part 2A of Form ADV to their existing retail investors both annually and upon any changes to the Item 9 of Part 2A (disciplinary information). The Commission preliminarily believes that the benefits of preparing and delivering an annual relationship summary, regardless of the format of that delivery, would not outweigh the costs to produce and distribute. As noted earlier, the Commission anticipates that the terms of the business relationship between most firms and their retail investors would be relatively stable over time, except when a new account is opened or a significant amount of assets is moved from one type of account to another that is different from the retail investor's existing accounts, or other changes are made that result in a material change to the nature and scope of the firm's relationship with the retail investor. As a result, every new delivery would bring relatively small amount of information to retail investors.

We believe that mere public posting of the updated summary would not itself adequately inform retail investors about material changes to the relationship summary, and that firms providing communication of information about relationship summary updates to investors as described above is therefore necessary.

Finally, instead of proposing that firms may choose to communicate information about updated relationship summaries to existing retail investors instead of delivering an updated relationship summary, the Commission could have proposed that firms must deliver the updated relationship summary to each existing retail investor regardless of whether or not it communicated the information to retail investors in another way. While delivering the summary would provide retail investors with the full scope of changes being made to the summary in the context of existing information, the Commission preliminarily believes that allowing firms to communicate information about the updates as well as making the current version of the summary publicly available, via a firm's website (if the firm has a website) and on the Commission's website, provides flexibility for firms to utilize existing communication methods and reduces the costs of delivery on firms while providing adequate notice to retail investors about the updates to the relationship summary, as well as access to the updated summaries.

5. Request for Comments

The Commission requests comment on all aspects of the economic analysis, including the analysis of: (i) Potential benefits and costs and other economic effects; (ii) long-term effects of the proposed relationship summary on efficiency, competition, and capital formation; and (iii) reasonable alternatives to the proposed regulations. We also request comments identifying sources of data and that could assist us in analyzing the economic consequences of the proposed regulations.

In addition to our general request for comment on the economic analysis, we request specific comment on certain aspects of the proposal:

- Do commenters agree with the overall assessment that the relationship summary would benefit retail investors and assist them in making a choice of what type of account matches their preferences? Do commenters believe there are alternatives to the structure and content of the relationship summary that we have not considered that could make it more beneficial to retail investors? Are there any unintended costs of the relationship summary for retail investors that we have not considered?
- Do commenters believe that the proposed disclosures about relationships and services and fees are clear and effective enough? How would you recommend altering the presentation of these disclosures in order to increase their effectiveness?
- Do commenters agree the proposed disclosure of the categories of conflicts of interest would be beneficial to retail investors? How would you recommend altering the presentation of the conflicts of interest information so that costs are minimized?
- What additional costs and benefits do you envision with extending the disclosure of disciplinary history?
- Are there alternative key questions we should consider recommending that retail investors ask their financial professional? Are there questions we should exclude, and, if so, why? Do commenters agree with the concern that there could be potential costs associated with the list of proposed questions, such as anchoring the attention of retail investors to the list and thereby reducing the likelihood that they would explore other potential questions that could be important to them?
- What costs do commenters anticipate that firms and financial professionals will incur in implementing and complying with the proposed Form CRS, both initial and ongoing? Please provide estimates of the time and cost burdens for preparing, delivering and filing the proposed form. What costs do commenters expect firms and financial professionals will incur to prepare answers to the ''Key Questions to Ask'' in the proposed Form CRS? Please provide estimates of the time and cost burden for preparing to answer the questions.
- How do commenters anticipate that the benefits and costs of the proposed rule will be shared between broker-dealers and their clients; or between investment advisers and their clients?
- Do commenters anticipate that the benefits and costs of the proposed rule would be different across broker-dealers and investment advisers? What about dually-registered firms?
- Are retail investors likely to access and download relationship summaries of broker-dealers through EDGAR and investment advisers through IAPD?
- Are there other reasonable alternatives that the Commission should consider? If so, please provide additional alternatives and how their costs and benefits would compare to the proposal.

C. Restrictions on the Use of Certain Names and Titles and Required Disclosures

As discussed above, several studies suggest that retail investors may lack financial literacy and are confused about the differences between broker-

[660] *See supra* Section II.C.3.

dealers and investment advisers.[661] Part of this confusion may be related to the current use of professional names and titles as indicated by these studies and commenters.[662] This proposal would seek to reduce investor confusion related to the use of certain terms in firm names and professional titles and prevent retail investors from potentially being misled that their firm or financial professional is an investment adviser, resulting in investor harm. In particular, our proposed rule seeks to restrict a broker or dealer, and any natural person who is an associated person of such broker or dealer, when communicating with a retail investor, from using as part of its name or title the words ''adviser'' or ''advisor'' unless such broker or dealer is registered as an investment adviser under the Advisers Act or with a state, or such natural person who is an associated person of a broker or dealer is a supervised person of an investment adviser registered under section 203 of the Advisers Act or with a state, and such person provides investment advice on behalf of such investment adviser.[663] In addition to the restriction on the use of certain names and titles, we are proposing rules that require both broker-dealers and investment advisers to prominently disclose their registration status with the Commission and for their financial professionals to disclose their association with such firm in all print and electronic retail investor communications. Dual registrants would be required to disclose both registration statuses.

This section provides an analysis of the economic effects of the proposed rules relative to the baseline, including a discussion of the benefits and costs to the affected parties and the impact on efficiency, competition and capital formation. We also discuss reasonable alternatives to the proposed rules.

1. Broad Economic Considerations

The economic tradeoffs involved in the choice of names and titles by firms and financial professionals are complex and affected by a wide range of factors. In this section, we discuss under what conditions firm names and financial professionals' titles may convey information that is important to retail investors when they are searching for a provider of financial advice, as well as factors that are likely to matter for firms and financial professionals when choosing their names and titles. We also discuss some conditions where investor confusion over the information conveyed by the names and titles chosen by firms and financial professionals may lead to investor harm.

We believe that investors fall into a spectrum of knowledge about the providers in the market for financial advice. On one end of the spectrum, there are investors who may understand and correctly distinguish the types of services and standard of conduct provided by different types of firms and financial professionals. If firms and financial professionals use names that accurately describe their regulatory type, these types of investors would understand and expect that ''broker-dealers,'' or close synonyms thereof, would provide the services of, and be subjected to the standard of conduct applicable to, a broker-dealer, while ''investment advisers,'' or similar names and titles, would provide the services of, and be subject to the standard of conduct applicable to, an investment adviser. On the other end of the spectrum there are less knowledgeable investors who do not understand that there are different types of services that can be provided by firms or financial professionals, or differing applicable standards of conduct. These investors may not be able to discern from the name or title what type of service will be provided by a firm or financial professional. As a result, these investors may bear costs associated with their confusion, such as increased time and effort (''search costs'') to identify the right type of financial professional,[664] or harm associated with inadvertently selecting, or potentially being misled to select, a type of firm and financial professional that is not consistent with their preferences and expectations. The harm from a mismatched relationship could be, for example, a higher-than-expected cost of services or reduced protection for the investor.

In addition to confusion over firm names and professional titles, and what they may represent, some investors may also have confusion over the type of brokerage, advisory and other services and standard of conduct that best match their preferences. Retail investors, therefore, can also be categorized based on whether they know the type of advice relationship (and associated payment model) that they would prefer, regardless of whether they understand the names and titles of firms and professionals. For instance, some investors may know that they prefer to receive and pay for advice on a per transaction basis, such as that provided typically by a broker-dealer, while others know they prefer an ongoing advisory relationship with an asset-based fee model, such as that typically provided by an investment adviser. On the other hand, some other investors may only understand that they are seeking financial advice but do not understand that there are different types of advice relationships, and different ways to pay for advice, and may not correctly identify the type of advice relationship that would be most consistent with their preferences. This dimension of investor confusion could also lead to investor harm such as increased search costs, an overall mismatch in the type of advice relationship, or paying more than expected for services received.

In principle, firm names and professional titles used by financial intermediaries, to the extent that names and titles accurately reflect the financial services provided, may serve as a search tool for some investors when they initially select which financial professionals to approach. In particular, for investors that both understand and correctly interpret company or professional names and titles and also know the type of investment advice relationship that they prefer, names and titles of firms and financial professionals that are mainly associated with one type of financial services could be used as an initial sorting mechanism that may reduce search costs. For example, to the extent names and titles accurately reflect the type of firms and financial professionals, knowledgeable investors that prefer only brokerage services could lower their search costs by using names and titles to increase the likelihood they would contact broker-dealers rather than investment advisers in their search. Similarly, knowledgeable investors looking to hire an investment adviser would more easily be able to contact investment advisers and avoid contacting broker-dealers simply by observing the firm or professional names and titles. We also note that investors who understand the

[661] *See* Siegel & Gale Study, *supra* note 549 and RAND Study, *supra* note 5. Although these studies do not limit the types of financial professionals exclusively to broker-dealers or investment advisers, the majority of the survey questions focus on differences between advisory services versus brokerage services.

[662] *Id. See supra* note 4.

[663] *See* section 202(a)(25) of the Advisers Act [15 U.S.C. 80b–2(a)(25)] defining ''supervised person'' as any partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser.

[664] According to the 2009 National Survey Initial Report (*see supra* note 275), of the 816 survey respondents that used a financial professional in the last five years, 56% indicated that when looking for a financial professional, they met or talked with more than one professional before making their choice.

differences between broker-dealers and investment advisers generally are unlikely to face a mismatch in the selection of a financial professional, and that the names and titles, in this case primarily serve to reduce search costs.

Less knowledgeable investors may face confusion over either the information conveyed by firm or professional names and titles or the preferred scope of their advice relationship. To the extent that names or titles used by financial intermediaries accurately reflect services provided, any reduction in search costs or reduction of the risk of investors matching with the wrong type of firm and financial professional will depend on the nature of the investor confusion, as we discuss in more detail below.

When selecting firm or professional names and titles, financial services providers may account for the level of investor understanding (or confusion). For example, they may be aware that some investors are informed by the use of particular names and titles, and the implications for the services provided and applicable standard of conduct, while other investors may face confusion over the use of particular names and titles or the type of advice relationship they seek. The incentives of financial intermediaries are two-fold: (1) They seek to build their client/customer base; and (2) they desire to reduce the costs associated with building that client/customer base, such as the time, effort, and marketing costs incurred in the initial client acquisition process. Therefore, financial intermediaries would rationally choose titles that effectively attract the attention of potential investors, while reducing the likelihood of ''false starts'' with investors that are not the right match (and understand what type of advice that they seek). For example, if investors that fully understand the differences between different types of financial intermediaries are a significant majority of the potential investor pool, then profit maximizing financial intermediaries would likely choose names and titles that clearly identify the nature of services provided and applicable standard of conduct. These knowledgeable investors will then be able to identify from that choice of name or title whether the firm or financial professional will meet their preferred type of investment advice relationship, and therefore, the unambiguous choice of title by the financial professional both reduces search costs incurred by these investors and reduces the effort expended by the financial professionals to build their customer base.

Continuing the same example, the remainder of the investor pool would then consist of less knowledgeable investors, which would represent a small portion of the aggregate investor pool. These investors, in particular those who are confused about the differences among firms and financial professionals and what type of investment advice relationship they should seek, may be unlikely to understand from names or titles alone how well the financial intermediary would match their preferences, and therefore, will bear search costs and the possibility of mismatch even when names and titles provide little ambiguity for informed investors. However, we expect that when the hypothetical investor pool predominantly consists of investors who fully understand the differences between different financial intermediaries, as we assumed for this example, overall costs borne by both investors (*e.g.,* search costs) and financial intermediaries (*e.g.,* customer acquisition costs) are minimized by the use of distinct names and titles clearly identifying financial intermediary type.

As the hypothetical pool of less knowledgeable investors that face confusion over company names, titles, or services increases, the choice of names and professional titles by financial intermediaries become more complex to analyze and depends on a number of factors related to investors. These factors include, among others: (i) Whether and how much these investors infer information from titles about the type of advisory or other services provided; (ii) the source of investors' confusion, such as (a) a lack of understanding about the type of service they would prefer, (b) an inability (in the absence of additional information) to understand the differences in the services offered and their associated payment models, or (c) a lack of knowledge about professional titles and information provided therein; (iii) how easily investors can learn, upon meeting with a financial professional, about whether the type of advice or other services provided by the financial professional meets their preferences; (iv) whether investors could be persuaded to choose a type of advisory service that is not consistent with the investor's preferences after meeting with a financial professional; (v) investors willingness or ability to keep searching for a financial professional until they find one that best matches their preferences; and (vi) the distribution in the investor pool of investors with different levels of knowledge and understanding as described above.

When less knowledgeable investors are confused not only about what services broker-dealers and investment advisers provide, but also are confused about the types of services that they would prefer, the factors noted above may lead firms and financial professionals of either type to rationally choose generic or common terms in names and titles. Consider the example where retail investors know they would benefit from financial advice in a general sense, but are confused about which type of investment advice relationship and associated payment model would be best for them.[665] A portion of these investors are also persuadable, to some degree, to contract for whatever service is offered to them by any given financial professional they contact, regardless of whether that type of service matches the investors' preferences.

In this case, and in order to maximize the number of investors that a firm or financial professional may be able to contract with, both broker-dealers and investment advisers facing these less knowledgeable investors would have incentives to pick names and titles that are the most effective at getting these investors to approach them, to the extent that names or titles alone have any impact on the choices made by these investors.[666] Once these investors make contact, a firm and financial professional hypothetically may be able to persuade the investor to hire them regardless of the type of financial advice relationship offered, to the extent that the investor cannot distinguish the characteristics of different types of advice relationships that best fit their preferences, does not know the most

[665] The assumptions underlying this hypothetical example are meant to be illustrative of the incentives of firms and financial professionals to pick certain names and titles when their pool of potential customers is relatively uninformed. Should the relationship summary disclosure be provided to potential and existing customers, we believe that some of the confusion regarding the nature of services would be addressed/mitigated; however, some investors may still, even in the event that the relationship summary is provided be confused about what type of firm or financial professional or which particular service is best for their investing situation.

[666] Although a number of studies discussed in the baseline provide survey evidence that investors are confused about titles, we are unaware of any direct evidence that titles alone affect the choice of firms or financial professionals that are contacted or eventually hired. However, in conjunction with the proposed relationship summary, we expect that investors would gain better understanding of the services provided by, and standards of conduct applicable to, broker-dealers and investment advisers, which could lead to more informed decision making about choosing the type of financial intermediary that best matches to the investors' own expectations regarding services and standard of conduct.

cost effective way to pay for that relationship, and cannot easily distinguish between the types of relationships that are offered by different firms and their financial professionals. In order to attract this type of investors, firms may favor titles that indicate their financial professionals' ability to dispense guidance and advice. For example, they may select titles that include the word ''adviser'' or ''advisor,'' such as ''financial advisor''.[667]

In addition to potential search costs expended by less knowledgeable investors, these investors also bear a greater risk of mismatch between the type of advice relationship that best fits their preference and the actual advisory service for which they contract. However, in this example, the mismatch arises because of investor confusion over the type of relationship that best would meet their preference, and this confusion itself may lead the investor to, by chance, seek out a type of firm or financial professional that is inconsistent with the investor's preference, rather than any confusion directly related to the firm's or financial professional's use of a common name or title. Conversely, generic names and titles may make it easier for less knowledgeable investors to identify a broader class of firms or financial professionals that can meet their perceived need for financial advice to some extent.[668] In situations where the pool of less knowledgeable investors is likely to be large, one likely outcome is that many firms and financial professionals could end up using similar names or titles, which would potentially increase search costs for those more knowledgeable investors who otherwise may use names and titles as an initial sorting mechanism.

Other particular kinds of investor confusion, which could impose costs on some investors, may provide benefits, such as increased customer flow, to only a certain type of firm or financial professional. For example, some investors may be fully aware of the type of advice relationship that they prefer, but are confused about which firm or professional names and titles are associated with that type of advice relationship. In particular, consider a situation where investors know that they would like an advice relationship that is provided by investment advisers. In this case, some broker-dealers may have incentives to use titles such as ''advisor'' that suggest such an advice relationship to maximize their customer flow. As a result, some less knowledgeable investors may be misled to wrongly approach broker-dealers rather than investment advisers in their search for advice, and bear both potentially higher search costs and an increased likelihood of a mismatch between the type of advice that is received and the type of advice that is preferred. The risk of a mismatch and associated harm in this case would be especially large for any of these investors that primarily base their choice of firm and financial professional on names and titles, rather than any information they would receive from a firm or financial professional about the type of services or applicable standards of conduct.

In addition to the factors related to investors discussed above, the selection of names and titles by financial intermediaries also depend on other factors specific to the intermediary. For example, competitive concerns may cause some financial intermediaries to simply choose terms in names and titles that are commonly used by other financial intermediaries of their type. Alternatively, firms may choose names and titles that distinguish them from their competitors. Some firms or financial professionals may choose ambiguous generic titles, such as ''financial consultant,'' in order to capture a larger fraction of the investor pool, thinking that investors may seek information if the title does not clearly identify the kinds or levels of services provided or the applicable standard of conduct. We acknowledge that these factors could also be important determinants of the choice of names and titles.

2. Economic Effects of the Proposed Restrictions on the Use of Certain Titles and Required Disclosures

In this section we discuss the potential economic effects from the proposed rules to the directly affected parties: Investors, standalone broker-dealers, standalone investment advisers, dually registered firms, and financial professionals. Potential economic effects on indirectly-affected parties, in particular financial intermediaries not regulated by the Commission, are discussed in the next section.

a. Investors

The objective of the proposed rules is to reduce retail investor confusion and limit the ability for retail investors to be misled that a firm or financial professional is an investment adviser as a result of the use of firm and financial professional names and titles that contain either ''adviser'' or ''advisor''. Specifically, our proposed rule seeks to enable retail investors to be able to discern more fully whether a particular firm or financial professional will offer advisory or other services provided by investment advisers versus those provided by broker-dealers. In this section, we discuss the potential benefits to investors as a result of the proposed rules, while considering the potential costs that could be borne by investors. In general, we expect the benefits and costs are unlikely to be evenly distributed among investors, but will rather depend on both the differences in investors' preferences for broker-dealer or investment adviser services, and investors' individual degree of understanding what services any given firm or financial professional is providing and the standard of conduct that is applicable.

i. Benefits of Restrictions on the Use of Certain Names or Titles

The proposed restriction on the use of the terms ''adviser'' and ''advisor'' in names and titles of broker-dealers who are not also dually registered as investment advisers and of financial professionals who are not supervised persons of investment advisers and who provide advice on behalf of such advisers, may reduce investor confusion about what type of firm or financial professional is likely to match with their preferences for a particular type of investment advice relationship. The proposed rule may also reduce corresponding search costs for some investors under certain conditions. Moreover, the proposed rule may reduce the likelihood that a mismatch between an investor's preferences and the services offered by a firm or financial professional occur.[669] Specifically, to the extent investors looking for an advice relationship of the type provided by investment advisers, and believe that

[667] Alternatively, these firms may choose relatively generic names or titles that in other ways suggest an advisory service, such as ''financial planner'' or ''financial consultant,'' which are not subject to the present rulemaking proposal.

[668] To the extent generic titles in use today such as ''financial planner'' and ''financial consultant'' make it more likely less knowledgeable investors can identify both investment advisers and broker-dealers that offer advice, there may be benefits to some of these investors if they in their contacts with financial professionals of both types learn about which relationship and payment models is most consistent with their preferences.

[669] We note that a potential mismatch could occur because investors may contact the wrong type of firm or financial professional and may not fully understand the type of financial advice that best match their preferences (even if the proposed relationship summary is made available), may be persuaded to hire the wrong type of firm or financial professional, or may be misled that a firm or financial professional will provide the type of service that the investor prefers, but in fact, does not.

names or titles containing the terms ''adviser'' or ''advisor'' are associated with this type of advice relationship, the proposed rule would make it easier to identify firms and financial professionals that offer such advice relationships, thereby reducing investor confusion, search costs, and any mismatch in the advice relationship that may occur from the potential misleading nature of such names or titles, as well as any associated harm with such mismatch.[670]

As a result of the proposed restriction on the use of certain terms, we expect the greatest potential reduction in search costs for retail investors who know that they specifically want the services provided by investment advisers and also would use names and titles in their search. The proposed rule would potentially make it easier for such investors to distinguish firms and professionals providing investment adviser services from firms and professionals providing brokerage services. The proposed rules may also reduce search costs for investors that prefer brokerage services, if standalone registered broker-dealers and financial professionals who are not supervised persons of an investment adviser or who are supervised persons but do not provide investment advice on behalf of such investment adviser are using names or titles including ''adviser'' and ''advisor,'' would choose new names and titles due to the proposed rule that more distinctly indicate the types of services they provide, such as ''broker'' or ''broker representative.''

However, the reduction in search costs for retail investors as a result of the proposed rule would be limited to the extent the firms and financial professionals covered by the restriction on the use of the terms ''adviser'' or ''advisor'' are not currently using the proposed terms in their names and titles. Further, the potential impact of the proposed rule on search costs is likely to be mitigated to the extent the proposed rule is limited to firm names and job titles, and would not itself affect the use of terms, such as ''advisory services'' in other communications or using those terms in metadata to attract internet search engines.[671] Moreover, beyond registered investment advisers, dual registrants, and their supervised persons, other types of financial services providers, such as insurance companies and banks, may also continue to use the terms ''adviser'' and ''advisor'' in their names and professional titles, and any confusion and search costs borne by investors related to the use of such names and titles by financial intermediaries not affected by this proposed rule would not be reduced. As noted above, the Commission recognizes that terms such as ''financial advisor'' or ''financial consultant'' may be used by banks, trust companies, insurance companies, and commodities professionals.[672]

As discussed above in Section IV.C.1, some investors may be confused by names and titles and believe that certain names and titles are likely to specifically signal the type of advice services provided by firms and financial professionals that use those names and titles and the associated standard of conduct.[673] In particular, investors that prefer the type of investment advice relationship and the associated standard of conduct offered by investment advisers may believe that names or titles containing the terms ''adviser'' or ''advisor'' are only associated with that type of advisory relationship. If some of these investors are persuaded by financial professionals associated with broker-dealers (who are not themselves investment advisers or supervised persons of investment advisers who provide advice on behalf of such adviser) that they could have a similar type of advice relationship as they would with an investment adviser, a potential mismatch between investor preferences and the advice relationship received may occur, which in turn may lead to investor harm such as higher payments for the services by the investor than necessary.[674] Thus, the proposed prohibition on the use of ''adviser'' or ''advisor'' by certain broker-dealers may reduce the risk of a mismatch between investors seeking advisory services of the type provided by investment advisers and the type of services for which they contract, as these investors under the proposed restriction would be potentially less likely to be misled or inadvertently approach and hire a type of firm or financial professional that does not match with their preferences and expectations.

Because mismatch in investor preferences and the type of advice relationship they receive can potentially be very costly for investors by resulting in inefficient advice relationships, reducing this cost could be a potential benefit of the proposed rule for some investors. In particular, if an investor seeks an advice relationship of the type offered by investment advisers, but mismatches to a brokerage relationship, then the frequency of advice received may not be the most appropriate, or the cost for the advice may be too high if it leads to frequent trading, and could result in suboptimal investment decisions or lower investment returns net of costs. The Commission preliminarily believes this reduction in mismatch risk would mainly apply to those investors seeking a relationship similar to that provided by investment advisers, as discussed above. However, for at least some investors requiring advice on a per-transaction basis, the confusion about the use of titles or the services provided by financial professionals could potentially lead them to inadvertently select investment advisers even if they truly want a broker-dealer. To the extent the proposed rule would also help these investors more clearly distinguish between broker-dealers and investment advisers, they may avoid inadvertently hiring an investment adviser and thereby avoid paying potentially higher fees for that type of advice relationship.

At this time the Commission is unable to estimate how many investors have contracted for services that do not meet their preferences, or are paying more than they would have preferred for services, due to confusion about the names and titles of financial intermediaries. Further, to the extent that confusion exists among retail investors regarding the names and titles used by firms and their financial professionals, surveys of retail investors with brokerage accounts suggest that they tend to be satisfied with their firms and financial professionals, and also believe that services provided by these firms and financial professionals are valuable, which further complicates any estimate of the incidence or magnitude of harmful mismatch.[675]

As discussed above with respect to search costs, any reduction in mismatch risk associated with investor confusion over names and titles would be limited to the extent that standalone registered

[670] *See supra* discussion in Section IV.C.1.

[671] As discussed above, these other communications by firms and financial professionals would continue to be subject to antifraud rules. *See supra* note 309.

[672] *See supra* note 400. Further, as identified by Commission staff, as of December 2017, approximately 546 broker-dealers reported at least one type of non-securities business, such as insurance, retirement planning, and real estate; *see supra* note 459.

[673] As discussed in Section IV.A.3.b, survey evidence suggest that many investors in general do not have a clear understanding about the differences in the nature of the advisory services provided by, and standard of conduct applicable to, different types of financial professionals.

[674] Broker-dealers may elect to provide some services similar to those of many investment advisers, such as ongoing monitoring, thereby potentially mitigating any mismatches between preferred services and the services provided.

[675] *See* RAND Study, *supra* note 5, at 98.

broker-dealers and their associated natural persons do not use the proposed prohibited terms in their names and titles. This would also be the case to the extent that registered representatives of dually-registered broker-dealers who are not themselves supervised persons of an investment adviser or who are supervised persons but do not provide investment advice on behalf of such investment adviser do not use those terms. The potential reduction in mismatch risk due to this proposed rule would also be limited to extent the rule is limited to firm name and individual job titles, and would not itself affect firms and financial professionals from using terms such as ''advisory'' in other content. Moreover, other types of financial intermediaries may use the terms ''adviser'' and ''advisor'' in their names and titles, such as banks, trust companies, insurance companies, and commodities professionals.[676] Therefore, the potential gains associated with a reduction in mismatch risk due to the prohibition on certain names and titles may be limited because some confused investors seeking an advice relationship from investment advisers could continue to inadvertently hire these other types of financial intermediaries that also use ''adviser'' or advisor'' in their names and titles.

Another potential limitation of the proposed restriction on the use of certain titles is that a dual registrant could still call itself an ''adviser'' or ''advisor,'' but then only offer brokerage services to investors that may not be legally and financially sophisticated enough to understand the differences in types of relationships and standards of conduct available.[677] Finally, for retail investors that rely on professional or personal recommendations in their search for financial professionals, the proposed prohibition on the use of certain titles is likely to have a limited effect on both search costs and the risk of mismatch in the advice relationship.

ii. Costs of the Restriction on the Use of Certain Titles

Although the Commission preliminarily believes that the proposed rule would decrease investor confusion, search costs, and mismatch for some segment of the investor pool that search for professionals based on names or titles, investor confusion and search costs could increase for those that would have, in the absence of the rule, selected broker-dealers and associated natural persons that would have to change their company names or titles as a result of the proposed rule.[678] For example, prospective customers familiar with a firm's name or financial professional's title may be especially confused by a change of either name or title to the extent that the term ''adviser'' or ''advisor'' is part of the firm's name brand or the titles of the professionals. Any increase in confusion as a result of the rule along these lines would likely be larger if the changed names or titles of broker-dealer firms that currently contain the words ''adviser'' or ''advisor'' are widely recognized as brands by investors.[679] Further, even if the broker-dealer name or title is unlikely to change, some investors may remove certain firms from their search list as professional names or titles change as a result of the rule. If, for example, a prospective investor is using the search term ''financial advisor'' to search for firms and financial professionals located in their city, some firms and financial professionals will be removed from any possible searches by these investors as a result of the proposed rule, even though these financial professionals might have been the best match to the preferences and expectations of the investor. However, these kind of potential costs to some current investors are likely to be limited to the extent that proposed rule is limited to firm name or title and individual job name or title and would not require firms and financial professionals to remove the restricted terms from other content, if they are not using such terms as a name or a title.

The proposed rule may also increase investor confusion to the extent some firms and financial professionals invent new names or titles to substitute for the restricted ones. Studies already indicate that the wide variety of names and titles used by firms and financial professionals causes general investor confusion about the market for investment advice. The magnitude of such costs is hard to predict, but would likely increase search costs for less knowledgeable retail investors that use names or titles to search for financial professionals or firms, and may also increase the likelihood of a mismatch for some of these investors between the type of advice relationship they prefer and the type of firm and financial professional they hire.

Investors seeking advice from broker-dealers may also face potential harm if some broker-dealers change their business model as a result of the proposed rule. As discussed above, we believe that most broker-dealers that would be subject to the restrictions of the proposed rule have chosen names and titles to build their customer base. Given that the market for investment advice overall appears to be relatively competitive, with respect to the number of firms and financial professionals, firms and financial professionals likely have chosen names or titles that they view as effective in marketing their services to investors. Therefore, being forced to switch names or titles could reduce the potential customer flow for some broker-dealers (and registered representatives of dual registrants who are not supervised persons of an investment adviser or who are supervised persons but do not provide investment advice on behalf of such investment adviser) who currently are using name or titles which include the term ''adviser'' and ''advisor'' and who serve retail investors. In lieu of adopting a new name or title without ''adviser'' or ''advisor,'' these firms or financial professionals might respond by exiting the retail investor market, or may bypass the compliance and other costs associated with this proposed rule by also registering as investment advisers or becoming supervised persons of an investment adviser who provide investment advice on behalf of such investment adviser, which would change their incentives to market their brokerage services to investors.[680] Either of these changes to business practices could reduce the availability of broker-dealer services for investors.[681] To the

[676] *See supra* note 400.

[677] As discussed above, however, financial professionals who are not themselves investment advisers or supervised persons of investment advisers and who provide advice on behalf of such advisers would also not be able to use the terms ''adviser'' or ''advisor'' in their professional titles.

[678] As discussed in the baseline, several studies indicate that many investors receive personal or professional referrals in the selection of their broker-dealer or investment advisor. However, even these investors may investigate these referrals prior to undertaking outreach, and therefore, may avoid certain financial professionals as a result of the name or title change.

[679] As discussed in the baseline, approximately 87 broker-dealers that are not dually registered as investment advisers and do not report non-securities business use the words ''adviser,'' ''advisor,'' or ''advisory'' as part of their current company name. These firms would likely have to change their company name as a result of this proposed rule. However, any loss in brand value due to this change could be mitigated to the extent the prohibited terms are not an important part of the firm's brand.

[680] Some firms could potentially increase their profits by moving some customers from a brokerage account to an advisory account (*e.g.,* customers who rarely trade). Such firms would have incentives to cut back on marketing of existing brokerage services to such customers and instead market the new advisory services.

[681] For example, in the event of exit by a broker-dealer, investors who want broker-dealer services would be forced to undertake search costs to find another firm and financial professional to meet

Continued

extent the costs of exiting the retail investor market or associated initial and ongoing costs of becoming a registered investment adviser (or a supervised person of an investment adviser who provides investment advice on behalf of such investment adviser) are greater than the costs associated with complying with the proposed rule, the likelihood of exit from the retail market or a change to the existing business model from a brokerage to advisory model would be low. In this case, the anticipated effect on investors from the loss of existing broker-dealer advice is expected to be limited. However, if it is costlier to change names or titles than to switch business model for broker-dealers, we expect some investors may experience a reduction in supply of broker-dealer advice services. Finally, because the Commission recognizes that a standalone broker-dealer can provide advice to retail investors without being regulated as an investment adviser provided that such advice is merely ''solely incidental to'' its brokerage business and the broker-dealer receives no ''special compensation'' for the advice, the proposed restriction would not prevent standalone broker-dealers from conveying the services that they provide in other content, without using the titles or names ''adviser'' or ''advisor.'' This may also limit the likelihood of exit from the retail market or a change to the existing business model from a brokerage to an advisory model.

The proposed rule could, however, also increase the risk of mismatch for some investors by removing standalone registered broker-dealers and registered representatives of dual registrants who are not supervised persons of an investment adviser from the pool of financial intermediaries that use the terms ''adviser'' or ''advisor'' in names and titles, while not affecting the use of these terms by other types of financial intermediaries, including banks, trust companies, insurance companies, and commodities professionals. Investors who are seeking financial services from either investment advisers or broker-dealers could instead inadvertently hire other types of financial intermediaries that would continue use these terms ''adviser'' or ''advisor,'' thereby potentially exacerbating the degree of mismatch between the type of relationship that they seek and what they receive. Further, neither this rule nor the proposed relationship summary would address the potential mismatch because these entities and natural persons are outside of the scope of the Commission rules. The Commission is not able to estimate the scope of this continuing potential for mismatch because we do not have access to information on the extent to which retail investors include these other types of financial intermediaries (deliberately or inadvertently) in their search for financial advice, nor the extent to which they see the services provided by these other financial intermediaries as substitute for the services provided by investment advisers or broker-dealers.

Another potential cost for investors is that affected broker-dealers may attempt to directly pass through any costs they would incur due to the proposed restriction on certain names and titles. A broker-dealer's incentives for such pass-through behavior would be attenuated the more competitive the broker-dealer's local market is in the sense that price sensitivity of demand is high.

Finally, we note that many of the costs and benefits to investors that we discussed above depend on the extent that titles and names affect investors' selection of their financial professional. The evidence discussed in Section IV.A.3.a suggests that between 40% and 50% of investors find their financial professionals through personal recommendations.[682] For this set of investors, the proposed rule would likely have little impact on search costs or potential for mismatch between their preferences and expectations and the type of advisory service for which they contract. We also note that we are not able to provide quantitative estimates of potential changes in search costs. Search costs for investors as well as costs due to mismatch would depend on a large set of individual specific factors, such as exactly what procedures investors use to search for financial professionals, what restrictions they put on their search (for example, choice of market, how many firms or professionals they are willing to sample before making a decision), the method they use to evaluate different alternative financial professionals they have identified, etc. The costs will to a large part not be monetary in nature but rather in the form of time and effort spent. The monetized value of that time and effort will also be individual specific. We do not have access to data that would provide us with this type of information, which we would need to estimate search costs. Similarly, we also are unable to provide estimates of changes in costs due to changes in the potential for mismatch as we do not currently have data on the percentage of the investor population that is mismatched, or the extent of harm that comes from mismatch.[683] For example, we don't have an analysis of how well someone would have done in their portfolio (especially after costs) if they had been correctly matched.

iii. Benefits and Costs of the Required Disclosures About Regulatory Status of a Financial Services Provider

We anticipate the proposed requirements for broker-dealers and investment advisers and their associated natural persons and supervised persons to prominently disclose their registration (or firm association for financial professionals) status in retail investor communications would reduce investor confusion as well as search costs associated with locating and hiring a firm, which could reduce the probability of mismatch for investors seeking advice. In particular, for investors who understand the meaning of the registration status and know they want to hire either a registered broker-dealer or a SEC-registered investment adviser, we expect the search for the correct type of firm will be made both clearer and less time consuming, as these investors will more readily observe the registration status. Search costs for investors for whom the registration status has little meaning, however, are not expected to experience a decrease in either confusion or search costs due to these disclosure requirements. Disclosure may also reduce the possibility of mismatch of hiring the wrong type of firm for investors who understand the meaning of the registration status and know what type of financial intermediary they want to hire, although we note that the likelihood for such mismatch is likely lower in the first place for such investors compared to less knowledgeable investors. For the pool of investors that are confused by both the type of advice relationship that they

their perceived needs, but also bear an increased cost associated with mismatch if they choose the wrong type of firm and financial professional. In the event of a switch from a brokerage model to an advisory model, investors may be forced to bear the costs associated with an advisory account that could exceed costs associated with services provided by a broker-dealer, or face costs associated with search and mismatch if they choose to change financial intermediaries, as discussed above.

[682] RAND Study, *supra* note 5 and 917 Financial Literacy Study, *supra* note 20.

[683] To estimate the potential harm from mismatch we would need to analyze how well someone could have done in their portfolio (after costs) if they had been correctly matched. This requires a rich set of investor characteristics as well as information about the investment menus and fee structures of potential alternative firms and financial professionals investors could have hired. We do not currently have access to such detailed information.

prefer, including how they want to pay for it, as well as professionals' titles, disclosure of registration status alone may not be sufficient to alleviate confusion in the type of advisory services provided by or the standard of conduct applicable to firms or financial professionals. Finally, for retail investors that rely on professional or personal recommendations in their search for financial professionals, the disclosure requirement is likely to have a limited effect on both search costs and the risk of mismatch in the advice relationship. As discussed above, we do not have access to information that would allow us to provide quantitative estimates of the potential costs and benefits to the investor from these proposed disclosure requirements.

In general, we do not anticipate any costs to investors from the proposed rules to disclose registration status. However, it could be that firms may attempt to pass through any compliance costs to investors through higher fees, in particular those that operate in markets where the price sensitivity of demand may be lower. Given that compliance costs would be of a one-time nature, as discussed above, we believe the likelihood and magnitude of such pass-through would be low.

b. Standalone Registered Broker-Dealers

The proposed rule would restrict broker-dealers who are not dually registered as investment advisers and their associated natural persons who are not themselves investment advisers or supervised persons of investment advisers that provide advice on behalf of such advisers from using the terms ''adviser'' or ''advisor'' when communicating with retail investors. As described previously in Section IV.A.1, approximately 87% of retail facing broker-dealer firms and 50% of registered representatives are not dually registered as investment advisers, and therefore potentially could be affected by the proposed restriction. The fraction of standalone broker-dealer firms that are currently using the terms ''adviser'' or ''advisor'' in their firm names or titles and do not report a non-securities business, is only approximately 3.5%.[684] When it comes to names or titles by registered representatives at standalone broker-dealers, the RAND Study evidence discussed in Section IV.A.1.f suggests that around 31% of professionals providing only brokerage services used titles containing the terms ''adviser'' or ''advisor.'' If the evidence presented in the baseline, is representative of the overall universe of standalone registered broker-dealers, the fraction of firms and associated natural persons that would be affected by the proposed prohibition may be relatively low.[685]

If the proposed restriction on certain names or titles would reduce potential investor confusion and prevent retail investors from potentially being misled, it could have some positive benefits for the subset of broker-dealers that would be impacted by this restriction but are not marketing advice services to attract business. In particular, these broker-dealers may be able to better attract customer flow and more efficiently target their marketing and advertising campaigns to reduce the likelihood of ''false starts'' associated with the potential mismatch with retail investors. Moreover, broker-dealers that are not dually registered may similarly benefit from the requirement to prominently display registration status as that may also help reduce investor confusion. Firms and financial professionals may also realize a limited benefit from this disclosure such that they can more effectively signal their type in communications, even when the firm or professional names or titles are not perfectly aligned with the registration status.[686]

For the segment of broker-dealers that would be affected by a restriction of using the terms ''adviser'' or ''advisor,'' we anticipate potentially substantial, one-time costs associated with the proposed rule. Broker-dealer firms subject to the restrictions on the use of certain names or titles would be required to change current company names or titles (if the company name or title contains ''adviser/advisor''), and marketing materials, advertisements (*e.g.,* print ads or television commercials), website and social media appearances that use the current company name or title, among other items, resulting in direct compliance costs. Similarly, all personal communications tools used by financial professionals, such as business cards, letterhead, social media profiles, and signature blocks would need to be amended to reflect new company and financial professionals' names or titles. The proposed requirement to prominently disclose registration status in print or electronic retail investor communications is also expected to require changes to the same set of materials and communication tools, and therefore, also would have to be modified to incorporate the registration status in the manner the rule prescribes.[687]

To the extent that the costs discussed above have a fixed-cost component (*i.e.,* a print ad would likely cost the same regardless of the size of the firm), the costs associated with producing new communication and advertising materials would be disproportionately higher for smaller broker-dealer firms. Other costs, however, may increase with the size of the broker-dealer, such as costs associated with revisions to each individual representative's communication and advertising materials, and therefore would increase with a broker-dealer's size.

[684] As discussed in *supra* Section IV.A.1.f, there are 87 (103 − 16 = 87) retail facing standalone broker-dealers without non-securities business that are currently using one of these terms in their firm names, which represents approximately 3.5% of the 2,497 retail acing standalone broker-dealers (2,857 − 360 = 2,497; *see supra* Table 1, Panel B). If we go beyond firm names and instead look at how firms' publicly describe themselves on their websites, the evidence presented in Section IV.A.1.f suggests that of the sampled standalone broker-dealers, less than 10% describe themselves using the terms ''adviser'' or ''advisor.'' Although some of these website descriptions may still be allowed under the proposed rule, it suggests that the fraction of standalone broker-dealers that rely on these terms to describe themselves may be relatively low.

[685] We estimate that approximately 226,132 (942,215 × 0.24 = 226,132; *see supra* Table 6) registered representatives of broker-dealers are not also registered as investment advisory representatives. Among these registered representatives, approximately 119,729 are employed by dually registered firms (494,399 × 0.61 × 0.397 = 119,729; *see supra* Section IV.A.1.e), which means 106,403 are employed by standalone broker-dealers. Further, if only 31% of broker-dealer registered representatives that are not dual-hatted (*see supra* Table 8) use titles containing the terms ''adviser'' or ''advisor,'' then we estimate that the total number of non-dual hatted registered representatives that would be potentially subject to this proposed prohibition would be 70,101, which is approximately 15.5% of all registered representatives. Of these representatives, 32,985 (0.31 × 106,403 = 32,985) are employed by standalone broker-dealers and approximately 37,116 (0.31 × 119,729 = 37,116) are employed by dual registrants. Note, the number of non-dual hatted registered representatives at dual registrants that would be potentially affected by the rule is likely lower than the estimated 37,166 because some of these representatives may be supervised persons providing advisory service without being dual-hatted. We are not able to estimate how large the fraction of such registered representatives would be. On the other hand, we do not have information about how many dual-hatted registered representatives among dual registrants that they are not supervised persons providing advisory services despite being dual-hatted, and therefore would also be subject to the proposed restriction on the use of certain titles.

[686] Note that any such benefits from the proposed rules relies on an assumption that some broker-dealers are not currently optimizing to receive such benefits by voluntarily changing names and titles or prominently display their registration status. However, as noted above, we expect in an efficient market, firms have already chosen names and titles that they view as effective marketing tools. As a result, we expect this benefit will be limited to the extent firms are currently rationally optimizing their choice of names and titles.

[687] *See infra* Section V.G for estimates of some of these compliance costs developed for the purpose of the Paperwork Reduction Act.

In addition to direct compliance costs associated with producing new materials, broker-dealers would likely bear costs associated with contacting current and prospective customers, whether by email, mass mailings, one-on-one meetings, or telephone conversations, to inform them of changes to names and titles. Such outreach on behalf of the broker-dealer or the individual representatives would inform existing and prospective investors of a name or title change, and whether or not any services have changed and may be necessary in order to minimize any confusion among current and prospective customers that could potentially lead to a loss of business during a ''changeover'' period.[688] This kind of outreach, however, could be costly to financial professionals and firms if it diverted time and resources away from the core business of the broker-dealer.[689] Further, the greater the name recognition of a current company or the larger the size of the company, the costlier such an outreach is likely to be as more current and prospective customers would need to be informed of the name change. Finally, to the extent that a broker-dealer's company name is recognized as a brand in the market and therefore represents a valuable intangible asset to the firm, some of its ''brand value'' may be lost following a company name change.[690] We note that the number of broker-dealer firms whose brand value may be negatively affected by the rule is relatively limited, as only around 3.5% of the broker-dealer firms that would be subject to the rule are using any of the prohibited terms in their company names.[691]

Likewise, broker-dealers facing no constraints on their choice of names and titles may choose the names and titles that they believe are the most effective at helping attract customers, and may best describe their business model, and reduce the effort associated with building a customer base, as described above.[692] Therefore, a segment of broker-dealers that are currently using terms that would be restricted under the proposed rule could experience a reduction in the efficiency of their marketing efforts, which in turn might lead to fewer customers and a loss of revenue compared to the baseline. In particular, those broker-dealers that rely on advice services as an important part of their value proposition to retail investors and directly compete with investment advisers may lose competiveness, if names and titles become less descriptive of this aspect of their business in the eyes of retail investors. These marketing efficiency costs would be mitigated to the extent the broker-dealers would use new names and titles that are equally efficient at conveying they are providing advice, or to the extent that the proposed restriction would not affect the use of terms such as ''advisory services'' in other content, or using them in metadata to attract internet search engines.[693]

Although we recognize that a significant fraction of a broker-dealer's customer base is attributed to referrals, as noted in the 917 Financial Literacy Study, approximately 25% of survey respondents rely on broker-dealer or financial professional names or titles in selecting their current advisor.[694] Depending on how effective the terms ''adviser'' or ''advisor'' are at attracting customers, costs associated with the loss of certain titles or names could be substantial for some broker-dealers.[695]

One way that affected broker-dealers could potentially mitigate the costs associated with the potential loss of titles or names could be for these firms to dually register as investment advisers. However, dual registration imposes an additional layer of regulatory oversight and compliance and need for training and licensing of employees to work as investment adviser representatives, which would also be costly. A broker-dealer would likely pursue such a strategy only if it expected the costs of regulation as an investment adviser were lower than the expected costs of modifying names and titles. We do not have access to data that would allow us to estimate either the total costs for modifying names and titles for broker-dealers, or the total costs of becoming an investment adviser for these broker-dealers.

c. Investment Advisers (Including Dual Registrants)

The proposed restriction on the use of the terms ''adviser'' and ''advisor'' in names and titles does not apply to registered investment advisers, whether they are solely registered as investment advisers or whether they are dually registered. Consequently, there would be no compliance costs for registered investment advisers associated with the restriction on the use of certain terms in names or titles. Some benefits could accrue to investment advisers at the expense of impacted broker-dealers. However, supervised persons of investment advisers who are dually registered but do not provide investment advice on behalf of such investment adviser would be prohibited from using the terms, which could lead to costs for those financial professionals or their firms.

Because the proposed restriction would force some standalone registered broker-dealers to change their names and titles in a way that may lead to less efficient marketing aimed at attracting potential investors, as discussed above, some customer flow that might have gone to these broker-dealers could be permanently diverted to investment advisers who will not be required to

[688] In particular, without outreach, some broker-dealers could experience a temporary reduction in the flow of prospective customers that would have relied on the use of titles prohibited by the proposed rule. In the absence of the prohibitions, these investors would have ended up contracting with the broker-dealers, but due to confusion over new company names and titles that would be required to be used, these investors may avoid broker-dealers subject to the change in names and titles, and these broker-dealers could earn less revenue. Only after the potential customer base becomes familiar with the new names and titles associated with a given broker-dealer and its financial professionals, or the search costs associated with these new titles decline, could these firms potentially recover a portion of the prospective customer base that was originally lost during the name transition period as a result of the changeover confusion. The Commission does not have access to the type of detailed customer information of individual broker-dealers that would allow us to estimate the percentage of customers that might be confused as a result of the name change or what fraction of these customers might eventually be recovered by a broker-dealer.

[689] Although such outreach is not required by the proposed rule, we anticipate that at least some percentage of affected broker-dealers or financial professionals would undertake such efforts in order to maintain good relationships with existing customers.

[690] Academic evidence suggest corporate brands are valuable intangible assets to firms; *see, e.g.,* M. E. Barth, M. B. Clement, G. Foster, & R. Kasznik, *Brand values and capital market valuation,* Review of Accounting Studies, 3(1), 41–68 (1998).

[691] *See supra* note 648. Specifically, 3% refers to the total number of broker-dealers that do not report non-securities business.

[692] *See* discussion in Section IV.C.1.

[693] Note that to the extent affected broker-dealers would choose other names and titles that convey a similar signal to investors as those containing the terms ''adviser'' or ''advisor,'' it would reduce the efficiency of the proposed prohibition. In Section IV.C.4.a we discuss an alternative that would prohibit a broker-dealer from otherwise ''holding out'' as an investment adviser, which would potentially also prevent the use of some similar names and titles.

[694] *See supra* note 20.

[695] For example, if investors know that they are seeking advice related to individual transactions (*e.g.,* the type of mutual fund or exchange-traded fund in which to invest), they may have a preference for terms such as ''financial advisor'' compared to terms such as ''financial planner'' or ''investment strategist,'' depending on their colloquial understanding of what an these terms might imply for the level of service and standard of conduct. If certain broker-dealers are restricted from using ''financial advisor,'' these firms may lose these potential customers. Moreover, these investors could potentially expend search costs as they sort through investment advisers that use the term ''financial advisor'' until the investor is able to match with the right type of financial professional.

change their names.[696] As a result, some investment advisers could experience an increase in revenues due to an increase in customer flow. The benefits may also be larger for investment advisers or dual registrants that are able to continue to use names or titles that include the term ''adviser'' or ''advisor'' as these terms could be the draw that currently attracts customer flow to certain firms and financial professionals, and that would be diverted due to a restriction on the use of these terms by standalone registered broker-dealers. In addition, assuming that small broker-dealers and investment advisers select geographic areas where competition from larger firms is low, then, as result of the proposed rule restricting the use of certain names or titles by broker-dealers, small investment advisers could especially benefit at the expense of small broker-dealers in these locations.

In terms of additional potential benefits, investment advisers and dual registrants, like standalone broker-dealers, will be subject to the required disclosure of their registration status, as part of the proposed rules. As we discussed in the case of standalone registered broker-dealers above, the prominent display of registration status could help reduce investor confusion, and could be used by both firms and their financial professionals as a marketing tool. Moreover, firms may benefit from this disclosure such that they can more effectively signal their type, even if the firm or professional names or titles are not perfectly aligned with the registration status. These potential benefits may be larger for dual registrants, as the prominent display of both their registrations may help attract investors that are looking for both types of services or investors who are generally unsure about which type of services they want.[697]

The proposed restriction on the use of certain names and titles would apply to financial professionals of dual registrant investment advisers who are not supervised persons of an investment adviser or who are supervised persons of an investment adviser but who do provide investment advice on behalf of such investment adviser, which could lead to costs for those financial professionals or their firms. Consistent with the discussion of standalone registered broker-dealer firms above, this segment of persons associated with dual registrants, and the dual registrants themselves, could bear a potentially substantial, one-time costs associated with the proposed rule to change marketing materials and other communications to remove the restricted terms and to explain the change to their customers. Further, some financial professionals using the restricted terms could experience a reduction in the efficiency of their marketing efforts. This could happen to the extent the terms were optimally chosen in the first place from a marketing perspective. This, in turn, might lead to fewer customers for the financial professional and his or her associated firm and a loss of revenue compared to the baseline. Furthermore, financial professionals that are not currently supervised persons of an investment adviser, or cannot immediately qualify to be hired in such a professional role may become less attractive to retain or hire by dual registrants, to the extent their services would be less valuable to dual registrants if they cannot use the terms ''adviser'' or ''advisor'' in their names or titles. These financial professionals could potentially mitigate the costs associated with the potential loss of names or titles by becoming a supervised person of an investment adviser and providing investment advice on behalf of such investment adviser. A financial professional would likely pursue such a strategy only if it expected the costs of becoming a supervised person of an investment adviser who provides investment advice on behalf of such investment adviser were lower than the expected costs of modifying their professional names or titles.

We expect the proposed requirements to prominently disclose registration status to impose one-time direct compliance costs associated with changes to written and electronic retail investor communications on both investment advisers and dually registered financial firms.[698] Similar to standalone registered broker-dealers, we expect that to the extent the required changes have a fixed-cost component, smaller investment adviser firms would incur relatively higher costs associated with this disclosure. Larger investment advisers and dual registrants, however, would likely bear an increase in the variable costs associated with such disclosures, as the amount of revisions associated with individual representative's and firm's communications will rise.[699]

3. Impact on Efficiency, Competition, and Capital Formation

In addition to the specific benefits and costs discussed in the previous section, the Commission expects that the proposed disclosure could cause some broader long-term effects on the market for financial advice. Below, we elaborate on these possible effects, specifically discussing the impact on efficiency, competition and capital formation.

a. Efficiency

As discussed above, the proposed rules have the potential to reduce investor confusion about the meaning of the names and titles used by firms and their financial professionals and to improve the matching between investor preferences and types of services they receive. To the extent retail investors use titles and names in their search for firms and financial professionals, the potential reduction in search costs would improve the overall efficiency of the market for financial advice by making the search process shorter in time and more cost effective. Moreover, to the extent the proposed rules would reduce the risk of any mismatch between investor preferences and the type of relationship their financial professional provides, it could lead to potentially improved efficiency in retail investors' asset allocation as investors would be more likely to receive investment advice that is optimal for their individual situation. A reduced risk of mismatch in the relationship would also make it less likely that investors pay more than necessary for the services they receive, which could lead to higher investment returns net of cost.

[696] To the extent that investor confusion about the market for financial services generally increases during the period when affected firms and financial professionals remove the term ''adviser'' or ''advisor'' from their names and titles, investment advisers that are not required to change their names or titles may see an increase in the diversion of customer flow from broker-dealers to investment advisers until investor confusion over the change in titles subsides. To the extent that some investors that are not currently making an efficient choice of a broker-dealer as indicated by investor confusion about titles and associated standards of conduct, and would choose an investment adviser after the proposed rules were adopted, this proposed rule change may assist them in making a more efficient choice to a service they would prefer.

[697] However, as noted previously, all firms and financial professionals can already voluntarily choose to prominently display their registration status, therefore implying that the direct benefits to firms and financial professionals from the proposed rule requiring disclosure of registration status may be limited.

[698] *See infra* Section V.H. for estimates of some of these compliance costs developed for the purpose of the Paperwork Reduction Act.

[699] Consistent with this argument, we estimate in the Paperwork Reduction Act analysis in *infra* Section V.H.2, that the initial one-time burden for complying with the disclosure requirements would be 72 hours per large investment adviser and 15 hours per small investment adviser.

Alternatively, as discussed previously, investor confusion may increase rather than decrease under certain circumstances, which would increase search costs for investors. In this case, we would instead expect a negative effect on efficiency. Moreover, there could also be negative effects on efficiency to the extent affected broker-dealers start using new names and titles that potentially convey the same information to investors as the restricted terms. Under such circumstances, the proposed rules would then only impose cost increases on broker-dealers without achieving any reduction of investor confusion. These costs may or may not be passed through to investors. In addition, some of the other potential costs outlined previously could have negative effects on efficiency. For example, this proposed rule could have a direct negative impact on efficiency in the registered broker-dealer segment of the market by making marketing less efficient for any affected broker-dealers (including any affected dual registrants with affected registered representatives). Further, any compliance costs or increased marketing costs may be passed through to investors in local markets where the competitive pressure is relatively low—for example, due to, a relatively low supply of financial professionals—and some investors may then face higher costs for broker-dealer services as a result. Finally, some affected firms and financial professionals may decide to exit the market if their costs of doing business go up substantially, which could decrease supply and increase costs of brokerage services for retail investors in some segments of the market. Any such increases in costs of broker-dealer services may also price some investors with limited ability to absorb a cost increase out of the brokerage market altogether, thereby limiting their access to advice and investment choices offered by broker-dealers and potentially hurting the efficiency of their investment allocation.

Because of the complexity associated with the use of names or titles by firms and their financial professionals, and their potential importance for investors both with respect to investor confusion and as a selection mechanism for hiring financial professionals, coupled with the lack of data on how investors could react to a restriction of the use of certain names and titles among broker-dealers and their associated natural persons, we are unable to provide estimates for the potential effects on efficiency. However, we preliminarily believe that any potential effects on the overall efficiency in the market for financial advice, or in segments of this market, are likely to be limited because of several factors that would mitigate the potential impact on investor confusion and/or the potential costs imposed on firms and financial professionals from the proposed restriction: (i) Only a fraction of standalone registered broker-dealers and their associated natural persons, as well as registered representatives working for dual registrants that are not dual-hatted are currently using the terms ''adviser'' and ''advisor'' in names and titles;[700] (ii) the extent to which the proposed restriction would not affect the use of terms such as ''advisory services'' in communications which do not convey a name or title; (iii) financial intermediaries and professionals not regulated by the Commission could still use the terms ''adviser'' or advisor'' in their names and titles.[701]

The proposed requirements to disclose a firm's regulatory status and a financial professional's association may increase the efficiency in the search and matching process in the market for financial advice to the extent retail investors understand the meaning of the registration status and would use it in their search for financial professionals. Among firms, the potential efficiency benefits may be larger for dual registrants, as the prominent display of both types of registrations may help attract investors that are looking for both brokerage services and an investment advice relationship, or investors who are in general unsure about which type of services they want.

b. Competition

The proposed rules could affect competition in the market for financial advice through potential effects on both demand and supply in the market. In terms of potential effects on demand, to the extent search costs are reduced for investors, it may raise the price elasticity of demand and consequently we would expect the competition between firms in this market to increase.[702] To the extent it is primarily investors who prefer the services provided by investment advisers who would experience a reduction in search costs, we would expect in particular an increase in the average price elasticity of demand for investment adviser services and therefore greater competition in the investment adviser market segment. However, a reduction in search cost may also increase retail investor participation in the market for financial advice. Investors at the high end of the search cost distribution who previously may have refrained from seeking financial advice altogether may enter the market for financial advice if there is a reduction in search costs. Because these new entrants to the market for financial advice would likely have higher search costs than the existing investors in the market, average investor demand elasticity may go down, which in turn would reduce competition at the margin.[703] To the extent it is mainly investors that prefer investment adviser services who would experience a reduction in search costs; we expect the new entrants to primarily belong to this group of investors. Therefore, the average demand elasticity may potentially decrease in particular for investment adviser services and reduce competition in the investment adviser market segment.

Conversely, if investor confusion and associated search costs instead are increased by the proposed rules, which as we discussed previously may happen under certain circumstances, it would likely lower price elasticity of demand among current retail investor market participants and reduce competition in the market for financial advice. However, if search costs are increased to the extent that current investors at the high end of the search cost distribution are induced to exit the market for financial advice altogether, it could instead increase average demand elasticity and increase competition among the firms in this market, as the

[700] The use of names and titles by firms and financial professionals is discussed in Section IV.A.1.f. Only around 87 current standalone broker-dealers with retail investors use the terms ''advisor'' or ''adviser'' in their company names. Further, around 31% of professionals providing only brokerage services used titles containing the terms ''adviser'' or ''advisor'' according to the RAND Study.

[701] *See* discussion of other such financial intermediaries and professionals in *supra* Section III.B.1.

[702] All else equal, we would expect customers in a marketplace with differentiated products to prolong their search for the right product at the right price if search costs are reduced. The resulting increase in demand elasticity would increase downward pressure on prices in the market, *see, e.g.* S. Anderson & R. Renault, *Pricing, Product Diversity, and Search Costs: A Bertrand-Chamberlin-Diamond Model,* The RAND Journal of Economics, 30, 719–735 (1999).

[703] For a theoretical model on how lower search costs may increase the average price elasticity of demand in this manner, *see, e.g.,* J. L. Moraga-González, Z. Sándor, & M.R. Wildenbeest, *Prices and heterogeneous search costs,* The RAND Journal of Economics, 48, 125–146 (2017). A study of the U.S. mutual fund industry also provide empirical evidence consistent with this type of effect; *see* A. Hortaçsu & C. Syverson, *Product differentiation, search costs, and competition in the mutual fund industry: A case study of S&P 500 Index funds,* The Quarterly Journal of Economics, Vol. 119, Issue 2, 403–456 (May 2004).

remaining investors would be those at the lower end of the search cost distribution and consequently would have higher price sensitivity. To the extent it is mainly investors that prefer broker-dealer services who would experience an increase in search costs we expect the investors exiting the market to primarily be such investors. Therefore, the average demand elasticity may potentially increase in particular for broker-dealer adviser services and increase competition in the broker-dealer market segment.

In terms of the effect on the supply of advice services, to the extent the proposed restriction on the use of certain names or titles would cause affected broker-dealers to register as investment advisers and start promoting that side of their business, or perhaps completely move to an investment adviser model, there would likely be a shift in the mix of supply of advice services, where the supply of broker-dealer (and associated registered representative) services could potentially decrease and the supply of investment adviser services could increase. Such a shift in the mix of the supply of advice services could potentially raise brokerage account prices, reduce choice for investors who prefer to pay for execution of trades on a transactional basis, and lower the costs of advisory accounts with investment advisers. However, to the extent some broker-dealers would exit the market for retail investors altogether, the overall supply of advice services could go down and we may see a decrease in competition not only in the market for broker-dealer services but also in the overall market for investment adviser services, assuming that retail investors view broker-dealer and investment adviser services as substitutes for one another, thereby increasing costs and limiting choices for retail investors. This potential negative effect on competition would be mitigated to the extent other firms (whether other broker-dealers or investment advisers) decide to compete for the customers of any broker-dealers exiting the market.

Further, to the extent the proposed restriction would make standalone broker-dealers services more costly and marketing less effective, non-affected standalone broker-dealers (*i.e.,* broker-dealers that do not use the restricted terms), dual-registrants, investment advisers, and financial intermediaries that are not registered as investment advisers (such as banks, trust companies, insurance companies, commodity trading advisers, and municipal advisors) may to a varying degree gain business at these affected firms expense. That is, by only affecting a subset of firms, the proposed restriction on the use of certain names and titles may change competitive positions among different suppliers in the market for financial advice. In addition, the proposed requirement to disclose registration status may benefit the competitive positon of dual registrants, as the prominent display of both types of registrations may help attract investors that are looking for both brokerage services and an investment advice relationship, or investors who are in general unsure about which type of services they want.

In addition, assuming that small broker-dealers and investment advisers select geographic areas where competition from larger firms is low, then any reduction of competition in the broker-dealer market due to a switch to an investment adviser business model would be particularly large in such geographic areas. Similarly, any reduction in competition due to exit of standalone registered broker-dealer altogether from the retail market would be particularly large in such geographic areas, where smaller investment advisers and dual registrants could especially see competitive benefits at the expense of small standalone registered broker-dealers.

We are not able to assess the magnitude of the potential demand or supply related effects as we do not have access to information that would allow us to do so, such as the distribution of search costs across the population of retail investors, estimates of the effect of the proposed rules on search costs, the internal cost functions of broker-dealers, etc. However, we preliminarily believe that the impact of any effects on the overall competitive situation in the market for financial advice is likely to be limited because of the same three mitigating factors we discussed above regarding the potential impact on efficiency.[704]

c. Capital Formation

Some aspects of the proposed rules could lead to increased capital formation, if, for example, retail investors are better able to allocate capital due to a better match with financial professionals or more retail investors enter the market for financial advice and start investing in securities. However, as discussed above, if some broker-dealers exit the market or move to an advisory business model as a result of the proposed rules, some investors may lose access to the market for advice serviced by broker-dealers, which may cause them to exit the market for financial advice altogether and reduce their (direct or indirect) investments in productive assets, thereby reducing capital formation. Alternatively, any investors who lose access to broker-dealers services may switch to an investment adviser relationship, which could reduce their investment returns net of costs to the extent the broker-dealer payment model was more optimal for their investment preferences, thereby also potentially reducing capital formation. Overall, the Commission is unable to determine how these countervailing effects could impact capital formation, and what the likely magnitude of those impacts would be. However, we preliminarily believe that the proposed rules would have a limited impact on capital formation because of the same three mitigating factors we discussed above regarding the potential impact on efficiency.[705]

4. Alternatives to the Proposed Rules

As discussed above, the proposed rule would restrict broker-dealers and their associated natural persons from using as part of a name or title the term ''adviser'' or ''advisor,'' unless such broker-dealer is dually registered as an investment adviser or the associated natural person is a supervised person of an investment adviser and provides advice on behalf of such investment adviser. Further, our proposed rules would also require both broker-dealers and investment advisers to disclose their registration status in print or electronic retail investor communications. Finally, the proposed rules would require associated natural persons of a broker-dealer and supervised persons of an investment adviser to disclose their association with a particular firm in print or electronic retail investor communications. Below, the Commission describes several alternatives to the proposed rules, including the continued ability of broker-dealers to rely on section 202(a)(11)(C) of the Advisers Act (the ''Solely Incidental'' exclusion), prohibitions on a broker-dealer ''holding out'' as an investment adviser, disclosure of the registration status only, or additional requirements for dual registrants.

[704] *See* discussion of mitigating factors in *supra* Section IV.C.3.a.

[705] *See* discussion of mitigating factors in *supra* Section IV.C.3.a.

a. No ''Solely Incidental'' Exclusion

As an alternative to the proposed rule restricting the use of the term ''adviser'' or ''advisor'' in names and titles, the Commission could propose a rule that stated that a broker-dealer cannot be considered to provide investment advice solely incidental to the conduct of its business as a broker-dealer under section 202(a)(11)(C) of the Advisers Act if the broker-dealer used the term ''adviser'' or ''advisor'' in names or titles, and therefore, would not be excluded from the definition of investment adviser. This alternative would rely on the assumption that a broker-dealer that uses these terms in its name to market or promote its services is doing so because its advice is significant or even instrumental to its brokerage business, and consequently, the broker-dealer's provision of advice is therefore no longer solely incidental to its brokerage business. Similarly, it would also rely on the assumption that if a broker-dealer invests its capital into marketing, branding, and creating intellectual property in using the terms ''adviser'' or ''advisor'' in its name or title, the broker-dealer is indicating that advice is an important part of its broker-dealer's business.

This alternative, like the proposed rule, would not permit an associated natural person of a dually registered firm to use the terms ''adviser'' or ''advisor'' in their names or titles unless such person was a supervised person of a registered investment adviser who provides investment advice on behalf of such investment adviser. For standalone broker-dealers, and their associated natural persons as well as associated natural person of a dually registered firm that are not supervised persons of a registered investment adviser providing advice on behalf of such investment adviser, that are currently marketing their services to retail investors using the terms ''adviser'' and ''advisor,'' in their name or title, the economic effects of this alternative would be expected to be substantially the same as under the proposed restriction on the use of the terms in names and titles.

b. Prohibit Broker-Dealers From Holding Themselves Out as Investment Advisers

Instead of prohibiting a broker-dealer from using certain names or titles, we could propose a rule to preclude a broker-dealer from relying on the solely incidental exclusion of section 202(a)(11)(C) if a broker-dealer ''held itself out'' as an investment adviser to retail investors. This approach could encompass a broker-dealer and its associated natural persons representing or implying through any communication or other sales practice (including through the use of names or titles) that they are offering investment advice subject to a fiduciary relationship with an investment adviser.

This approach would reduce the risk that by only proscribing ''adviser'' and ''advisor,'' or any other specific names and titles, new names and titles could arise with similar, confusing connotations. Moreover, this alternative could promote informed investor choices by focusing more comprehensively on broker-dealer marketing and titles that may confuse or mislead investors into believing that a brokerage relationship is an advice relationship of the type provided by investment advisers. Relative to either the baseline or the proposed rule, the ''holding out'' alternative could have a broader application because it could capture any communication or other sales practices that may lead to confusion by investors in believing that their firms or financial professionals provide more or different services than they provide. As a result, investor confusion and associated costs may be reduced more compared to the proposed rule.

This alternative, however, could create uncertainty for broker-dealers as to which activities (and the extent of such activities) would be permissible and not considered ''holding out'' as an investment adviser and therefore triggering the need to register as such. As a result of a ''holding out'' alternative, broker-dealers may feel compelled to avoid fully describing even the types of advisory services they are allowed to provide in their communications and marketing efforts and may also limit or reduce allowable advice provided by broker-dealers to avoid any instances where the advice provided could be misconstrued that such person is ''holding out'' as an investment adviser. Given that broker-dealers under the current regulatory environment are permitted to provide incidental advice related to recommendations of securities or investment strategies, investor confusion may be increased and some investors may believe that as a result of the ''holding out'' alternative that this advice could no longer be offered, and could face a mismatch in their preferences and expectations if they sub-optimally choose to hire investment advisers and avoid broker-dealers. Therefore, implementing a rule along these lines could have significant competitive effects for broker-dealers, and could reduce the effectiveness in how investors choose their firms and financial professionals. As a result of increased investor confusion, both search costs and costs associated with choosing the wrong type of firm and financial professional could be increased under this alternative. Moreover, if some broker-dealers avoid providing advice as a result of this alternative, some retail investors may be shut out of the advice market entirely or may have to incur higher costs that may be associated with investment advisory services.

From a compliance cost perspective, broker-dealers that could be subject to the ''holding out'' alternative would face costs in revising their communications and advertisements in order to eliminate any discussion about them implying they are offering investment advice subject to a fiduciary relationship with an investment adviser. To the extent such revisions have a significant fixed cost component or there are other economies of scale, such as decreasing variable costs for printed material as the number of copies increase, we would expect smaller broker-dealers to face relatively higher costs following the implementation of this alternative. There could also be increased costs under this alternative from training and monitoring of associated natural persons to ensure compliance with the rule, as the restrictions would be more principles-based than prescriptive compared to the proposed rule.

c. Disclosure of Registration Status Only

The proposed rules both prohibit certain names or titles and require disclosure of broker-dealer or investment adviser registration status in all written and electronic retail investor communications of broker-dealers and SEC-registered investment advisers, including those of individual representatives, such as business cards, social media profiles, and signature blocks on paper or electronic correspondence. As an alternative to the proposed rules, the Commission could not propose a restriction on the use of certain names or titles by standalone registered broker-dealers, and solely propose requiring disclosure of registration status in all written and electronic retail investor communications given by the firm or its representatives.

Although both broker-dealers and SEC-registered investment advisers would have to bear the cost of including a disclosure of their registration status in all written and electronic retail investor communications under this alternative, they would have to bear this cost under the proposed rules, as well.

This alternative, however, would allow broker-dealers to continue to use titles or names that include ''Adviser/Advisor'' and therefore would likely result in a lower overall cost of rebranding their financial professionals or the firm itself in all other communications.

While the costs of compliance with a disclosure of registration status only requirement would be lower than under the proposed rules, and would apply uniformly to all broker-dealers and investment advisers, this alternative could be less effective in reducing investor confusion over the titles or names used by financial professionals and firms, and the implications of the types of services provided by, or standard of conduct applicable to, these professionals to the extent the registration status is uninformative to retail investors because they do not understand the regulatory implications of a firm being registered as either a broker-dealer or an investment adviser.

Another potential, related, alternative would be to limit the disclosure of registration status only to certain marketing communications. The overall compliance costs to broker-dealers, particularly small broker-dealers that are less likely to produce advertising campaigns in either print media, television/radio broadcasts, mass mailings, or on websites, would be lower than under the requirements of the proposed rules for disclosure of registration status in all communications. This alternative, however, would likely reduce the potential benefits to retail investors, as only ''advertisements'' would be required to produce the disclosure of registration status, and could increase both search costs and the possibility of mismatch associated with choosing the wrong type of financial firm or professional. To the extent small broker-dealers or investment advisers are less likely to use these types of marketing communications to reach potential customers relative to larger broker-dealers and investment advisers (*e.g.,* because there are fixed costs in producing an advertisement, the reduction in benefits is more likely to affect retail investors that use such small broker-dealers or investment advisers). Therefore, the Commission preliminarily believes that the potential compliance cost savings for limiting communications that would require such disclosure do not justify the reduced level of investor protection under such alternative.

Another ''disclosure only'' alternative to the proposed restriction on the use of the terms ''adviser'' and ''advisor'' in names and titles would be to propose a rule that would provide that when any broker-dealer not registered under the Advisers Act chooses to distribute advertisements or other communications using the term ''adviser'' or ''advisor'' as part of a name or title, each use of the term would have to include an asterisked disclaimer clarifying its registration status. Under this alternative broker-dealers and their associated natural persons could continue to use these terms in their names and titles in retail investor communications, but investors would be potentially alerted by the asterisk to the actual registration status of the broker-dealer, which may reduce investors confusion about the type of services provided the associated standard of care to the extent they understand the meaning of the registration status. One limitation of this alternative, as well as the other alternatives discussed in this section, compared to the proposed rule is that some of the evidence on investor perceptions discussed previously in Section IV.A.3 suggest that many retail investors may not fully understand the meaning of the registration status. Moreover, the asterisked declaimer may not be salient enough to attract investors' attention to the disclaimer.

d. Additional Requirements for Dual Registrants

We estimate that the number of dual registrants represents approximately 13% of all retail broker-dealer firms and that approximately 65% of registered representatives of retail broker-dealers work at these dual registrants.[706] Although the proposed rule restricts supervised persons of dual registrants who do not provide investment advice on behalf of such investment adviser, a percentage of dually registered firms would not be affected by the proposed restriction of certain names and titles. To address this issue, we considered an alternative to the proposed rule which would prohibit the name or title containing the terms ''adviser'' or ''advisor'' unless a ''a substantial part of the business consists of rendering investment supervisory services.''[707] We also considered limiting dual registrants' use of the term ''adviser'' or ''advisor'' to when they provide advice to a retail investor in the capacity as an investment adviser, and prohibiting dual registrants from using such terms when acting in the capacity of a broker-dealer to a particular customer.

Under this alternative, some of the investor pool may face reduced confusion in their communications with their financial professional with regard to the use of specific names and titles, because these names and titles containing the term ''adviser'' or ''advisor'' would be limited only to the accounts or the instances in which the financial professional actually serves in the capacity as an investment adviser. However, these alternatives for dual registrants would create substantial compliance challenges for dual registrants. For example, dual registrants would have to ensure the appropriate name or title is being used when the financial professional is engaging in multiple capacities with investors. Moreover, requiring financial professionals that are dual registrants to tailor their names or titles based on what capacity they are acting in could increase confusion to investors, given that some dual registrants might act in broker-dealer and investment adviser capacities for a single investor. For example, a retail investor may have both a brokerage account and an advisory account, and may receive advice related to both brokerage recommendations as well as ongoing advice in the advisory account in a single communication.

5. Request for Comments

The Commission requests comment on all aspects of the economic analysis, including the analysis of: (i) Potential benefits and costs and other economic effects; (ii) long-term effects of the proposed restriction on the use of certain titles and required disclosure of registration status on efficiency, competition, and capital formation; and (iii) reasonable alternatives to the proposed regulations. We also request comments identifying sources of data and that could assist us in analyzing the economic consequences of the proposed regulations.

In addition to our general request for comment on the economic analysis, we request specific comment on certain aspects of the proposal:

• Do commenters agree with our assessment that the main potential

[706] As shown in *supra* Table 1, Panel B those broker-dealer firms that were registered in a dual capacity were 360 of approximately 2,857 firms (about 13%) as of December 31, 2017. Using data from Form ADV filings, these 360 dually-registered firms had approximately $4.3 trillion of AUM. As discussed in Section IV.A,1.e, almost all registered financial professionals at dual registrants are either dual-hatted or registered representatives. Because dual registrants employ approximately 61% of all licensed financial professionals (see *supra* Table 5) and approximately 94% of all financial professionals are either dual hatted or registered representatives (48/51 = 0.94; *see supra* Table 6), it means that approximately 65% (0.61/0.94 = 0.65) of all registered representatives, whether dual hatted or not, work at dual registrants.

[707] *See* section 208(c) of the Advisers Act.

benefits to retail investors are reduced search costs and a lower risk of mismatch? Are there other benefits of the proposed rule that have not been identified in our discussion and that warrant consideration? Are the assumptions that form the basis of our analysis of the benefits appropriate? Can commenters provide data that supports or opposes these assumptions?

- Do commenters agree with our characterization of the costs? Are the assumptions that form the basis of our analysis of the costs appropriate? Are there other costs to investors of the proposed rule that have not been identified in our discussion and that warrant consideration? Can commenters provide data that supports or opposes these assumptions?
- We request additional information on how retail investors search for financial professionals. In particular, are there studies, evidence or data available on how investors use company names and titles of representatives in their search for a financial professional?
- We request comments on our characterization of the benefits and costs to broker-dealers and investment advisers of the proposed rule. Do commenters agree with our characterization of the benefits and costs? Are there other benefits or costs of the proposed rule that have not been identified in our discussion and that warrant consideration? Are the assumptions that form the basis of our analysis of the benefits and costs appropriate? Can commenters provide data that supports or opposes these assumptions?
- We specifically request comments on the costs to broker-dealers from having to change their company names as a result of the rule. How costly do commenters believe it would be for affected entities that would be required to their change current company names, including the costs of marketing materials and advertisements? Do broker-dealer company names have significant brand value? To what extent does the brand value lie in terms such as ''adviser'' or ''advisor''?
- Do commenters believe standalone broker-dealers that would be affected by the proposed rule may decide to register as an investment advisers? Are there any specific types of standalone broker-dealers that would be more likely to respond in this way? Do you believe standalone broker-dealers registering as investment advisers would affect their supply of brokerage services? What are the compliance and indirect costs for broker-dealers who would seek to register as an investment adviser? Is there additional data to estimate such costs, either initially or on an ongoing basis?
- Are there any effects on efficiency, competition, and capital formation that are not identified or are misidentified in our economic analysis? Please be specific and provide data and analysis to support your views.
- Do commenters believe that the alternatives the Commission considered are appropriate? Are there other reasonable alternatives that the Commission should consider? If so, please provide additional alternatives and how their costs and benefits would compare to the proposal.

D. Combined Economic Effects of Form CRS Relationship Summary and Restrictions on the Use of Certain Titles and Required Disclosures About a Firm's Regulatory Status

Above, we have described the anticipated standalone economic effects of the proposed Form CRS relationship summary and the proposed restrictions on the use of certain titles and required disclosures about a firm's regulatory status relative to the current baseline. In this section, we discuss how we anticipate these economic effects could change when considering both these proposed rules in combination.

To the extent that investors may be confused and potentially misled about what type of investment advice relationship is best for their investing situation, being provided with the proposed Form CRS, along with the proposed restriction on names and titles, could incrementally reduce some of the investor confusion and mismatch risk. In particular, if a retail investor communicates with a financial professional associated with a dual registrant and the professional has a name or title containing either of the terms ''adviser'' or ''advisor'' but solely provides brokerage services, such investor would likely receive the dually registered firm's relationship summary. Because Form CRS would include a description of both business models, without the restriction on names and titles and the requirement of disclosure of registration status, some retail investors might incorrectly match the services they would receive from this financial professional to the description in the relationship summary of *investment advisory* services. In this case, the proposed restriction on names or titles and the requirement to disclose regulatory status would increase the effectiveness of Form CRS by reducing the risk of any mismatch between investor preferences and type of services received due to this kind of misunderstanding, which in turn may lead to harm such as the investor paying too much for advice if it if it leads to frequent trading. To the extent investors who received a relationship summary shares it with family and friends, the potential importance of having the restriction on the use of certain names and titles would be increased, because it could also reduce the risk of this type of misunderstanding being spread to a greater set of retail investors.

However, for those investors whose confusion about the differences between broker-dealers' and investment advisers' services and standards of conduct would be substantially reduced once receiving and reading a firm's relationship summary we expect a reduced overall incremental benefit of the proposed restriction on the use of certain names and titles. Specifically, because such investors would learn about the differences between broker-dealer and investment adviser services through the relationship summary, they may be unlikely to hire the wrong type of firm or financial professional even without the proposed restriction on the use of certain names or titles.

With respect to the initial search costs borne by investors, we do not believe that the relationship summary would alter the incremental effects the proposed restriction on certain names and titles may have on search costs, because the proposed Form CRS would generally be provided at a later stage in the search process (*e.g.,* after initial contact with a financial professional is made) relative to the initial stage where names and titles of firms and financial professionals may be a useful search tool to investors. Similarly, we do not believe that the relationship summary would alter the incremental effects on search costs from the proposed requirement to disclose registration status in retail investor communications, because investors would likely encounter communications disclosing a firm's registration status prior to being provided a firm's relationship summary.

We believe that the proposed Form CRS and the proposed required disclosures of registration status would complement each other because both are designed to reduce investor confusion. In particular, for less knowledgeable investors, the disclosure of registration status may raise awareness about the different forms of registration among financial intermediaries and their associated natural persons and prompt questions about the difference between registered broker-dealers and registered investment advisers. The relationship summary potentially could work in concert with the disclosure of registration status to facilitate investors' learning about the different types of financial firms and professionals because it would highlight many of the key differences between investment advisers and broker-dealers in different communications and different times, consistent with the layered approach to disclosure that the relationship summary is designed to further. Likewise, if the disclosure of registration status makes such status more salient to less knowledgeable investors, such disclosure may induce a more careful reading of related parts in the relationship summary or provide incentives to discuss the information contained in disclosure with a financial professional. Thus, the combination of the disclosure of registration status and the relationship summary may further help facilitate the search process also for investors initially confused about the difference between broker-dealers and investment advisers, and help them ultimately better match to an appropriate financial professional.

However, for more knowledgeable investors, there may be some overlap in function that could reduce the potential benefits to either the relationship summary or the disclosure of regulatory status without offsetting anticipated costs. As discussed previously, the disclosure of registration status may help to reduce search costs for investors who already understand the meaning of the registration status. These relatively knowledgeable investors may therefore already be familiar with some of the information in relationship summary by having encountered the disclosure of the registration status beforehand. In this case, the relationship summary may provide fewer additional benefits for these investors in either reducing search costs or the likelihood of mismatch, but would impose costs on both broker-dealers and investment advisers that must produce both the relationship summary and the disclosures of registration status.

Finally, we note that any complementarities between the proposed restrictions on the use of certain names and titles, required disclosures about a firm's regulatory status, and the proposed relationship summary would be constrained by the fact (1) the relationship summary does not need to be provided by state-registered standalone investment advisers and (2) these state-registered investment advisers (and their supervised persons) would not be required to provide registration status disclosures in retail investor communications pursuant to this proposed rule.

V. Paperwork Reduction Act Analysis

Certain provisions of our proposal contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[708] The Commission is submitting these collections of information to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The titles for the existing collections of information that we are proposing to amend are (i) ''Form ADV'' (OMB control number 3235–0049), (ii) ''Rule 204–2 under the Investment Advisers Act of 1940'' (OMB control number 3235–0278), (iii) ''Rule 17a–3; Records to be Made by Certain Exchange Members, Brokers and Dealers'' (OMB control number 3235–0033) and (iv) ''Rule 17a–4; Records to be Preserved by Certain Exchange Members, Brokers and Dealers'' (OMB control number 3235–0279). The new collections of information relate to (i) ''Rule 204–5 under the Investment Advisers Act of 1940,'' (ii) ''Form CRS and rule 17a–14 under the Exchange Act,'' (iii) ''Rule 15l–3 under the Securities Exchange Act,'' and (iv) ''Rule 211h–1 under the Investment Advisers Act of 1940.'' An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Commission is also including a short-form tear sheet for investors to provide feedback on the relationship summary.[709]

A. Form ADV

Form ADV (OMB Control No. 3235–0049) is currently a two-part investment adviser registration form. Part 1 of Form ADV contains information used primarily by Commission staff, and Part 2 is the client brochure. We are not proposing amendments to Part 1 or 2. We use the information to determine eligibility for registration with us and to manage our regulatory and examination programs. Clients use certain of the information to determine whether to hire or retain an investment adviser. The collection of information is necessary to provide advisory clients, prospective clients and the Commission with information about the investment adviser and its business, conflicts of interest and personnel. Rule 203–1 under the Advisers Act requires every person applying for investment adviser registration with the Commission to file Form ADV. Rule 204–4 under the Advisers Act requires certain investment advisers exempt from registration with the Commission (''exempt reporting advisers'') to file reports with the Commission by completing a limited number of items on Form ADV. Rule 204–1 under the Advisers Act requires each registered and exempt reporting adviser to file amendments to Form ADV at least annually, and requires advisers to submit electronic filings through IARD. The paperwork burdens associated with rules 203–1, 204–1, and 204–4 are included in the approved annual burden associated with Form ADV and thus do not entail separate collections of information. These collections of information are found at 17 CFR 275.203–1, 275.204–1, 275.204–4 and 279.1 (Form ADV itself) and are mandatory. Responses are not kept confidential.

We are proposing to amend Form ADV to add a new Part 3, requiring certain registered investment advisers to prepare and file a relationship summary for retail investors. As with Form ADV Parts 1 and 2, we will use the information to determine eligibility for registration with us and to manage our regulatory and examination programs. Similarly, clients can use the information required in Part 3 to determine whether to hire or retain an investment adviser, as well as what types of accounts and services are appropriate for their needs. The collection of information is necessary to provide advisory clients, prospective clients and the Commission with information about the investment adviser and its business, conflicts of interest and personnel. The proposal requiring investment advisers to deliver the relationship summary is contained in a new collection of information under proposed new rule 204–5 under the Advisers Act, which estimates are discussed in Section V.B below. We are not proposing amendments to Part 1 or 2 of Form ADV.[710]

1. Respondents: Investment Advisers and Exempt Reporting Advisers

The respondents to current Form ADV are investment advisers registered with the Commission or applying for registration with the Commission and

[708] 44 U.S.C. 3501 *et seq.*

[709] *See* Appendix F. The Commission determines that using this short-form tear sheet to obtain information from investors is in the public interest and will protect investors. *See* Securities Act section 19(e).

[710] We are proposing conforming technical amendments to the General Instructions of Form ADV to add references to the Part 3, but these amendments would not affect the burden of Part 1 or Part 2. *See* proposed amendments to Form ADV: General Instructions.

exempt reporting advisers.[711] As of December 31, 2017, 12,721 investment advisers were registered with the Commission, and 3,848 exempt reporting advisers report information to the Commission.

As discussed in Section II above, we propose to adopt amendments to Form ADV that would add a new Part 3, requiring certain registered investment advisers to prepare and file a relationship summary for retail investors. Only those registered investment advisers offering services to retail investors would be required to prepare and file a relationship summary. Based on IARD system data, the Commission estimates that 7,625 investment advisers provide advice to individual high net worth and individual non-high net worth clients.[712]

This would leave 5,096 registered investment advisers that do not provide advice to retail investors[713] and 3,848 exempt reporting advisers that would not be subject to Form ADV Part 3 requirements, but are included in the PRA analysis for purposes of updating the overall Form ADV information collection.[714] We also note that these figures include the burdens for 366 registered broker-dealers that are dually registered as investment advisers as of December 31, 2017.[715]

2. Changes in Burden Estimates and New Burden Estimates

Based on the prior revision of Form ADV,[716] the currently approved total aggregate annual hour burden estimate for all advisers of completing, amending and filing Form ADV (Part 1 and Part 2) with the Commission is 363,082 hours, or a blended average of 23.77 hours per adviser,[717] with a monetized total of $92,404,369, or $6,051 per adviser.[718] The currently approved annual cost burden is $13,683,500. This burden estimate is based on: (i) The total annual collection of information burden for SEC-registered advisers to file and complete Form ADV (Part 1 and Part 2); and (ii) the total annual collection of information burden for exempt reporting advisers to file and complete the required items of Part 1A of Form ADV. Broken down by adviser type, the current approved total annual hour burden is 29.22 hours per SEC-registered adviser, and 3.60 hours per exempt reporting adviser.[719] The proposed amendments would increase the current burden estimate due in part to the proposed amendments to Form ADV to add Form ADV Part 3: Form CRS (the relationship summary) and the increased number of investment advisers and exempt reporting advisers since the last burden estimate. We are not proposing any changes to Part 1 or Part 2 of Form ADV.

The proposed amendments to Form ADV to add Part 3 would increase the information collection burden for registered investment advisers with retail investors. As discussed above in Section II, we propose to adopt amendments to Form ADV, under Part 3, that would require certain registered investment advisers to prepare and file a relationship summary for retail investors. Only those registered investment advisers providing services to retail investors would be required to prepare and file a relationship summary. We propose to require that those investment advisers file their relationship summaries with the Commission electronically through IARD in the same manner as they currently file Form ADV Parts 1 and 2. Investment advisers also would need to amend and file an updated relationship summary within 30 days whenever any information becomes materially inaccurate.

As noted in Section V.A.1 above, not all investment advisers would be required to prepare and file the relationship summary. For those investment advisers, the per adviser annual hour burden for meeting their Form ADV requirements would remain the same, in particular, 29.22 hours per registered investment adviser without relationship summary obligations. Similarly, because exempt reporting advisers also would not have relationship summary obligations, the annual hour burden for exempt reporting advisers to meet their Form ADV obligations would remain the same, at 3.60 hours per exempt reporting adviser. However, although we are not proposing changes to Form ADV Part 1 and Part 2, and the per adviser information collection burden would not increase for those without the obligation to prepare and file the relationship summary, the information collection burden attributable to Parts 1 and 2 of Form ADV would increase due to an increase in the number of registered investment advisers and exempt reporting advisers since the last information collection burden estimate. In this section, we discuss the increase in burden for Form ADV overall attributable to the proposed amendments, *i.e.,* new Form ADV Part 3: Form CRS, and the increase due to the updated number of respondents that would not be subject to the proposed amendments.

a. Initial Preparation and Filing of Relationship Summary

For investment advisers that provide advice to retail investors, we estimate that the initial first year burden for preparing and filing the relationship summary would be five hours per registered adviser. As discussed above, much of the language of the proposed relationship summary is prescribed. Furthermore, much of the information proposed to be required in the relationship summary overlaps with that required by Form ADV Part 2 and therefore should be readily available to registered investment advisers because of their existing disclosure obligations. Investment advisers also already file the Form ADV Part 2 brochure on IARD, and we have considered this factor in determining our estimate of the additional burden to file Form ADV Part 3: Form CRS. In addition, the narrative descriptions required in the relationship summary should be narrowly tailored and brief, and the relationship summary must be limited to four pages (or

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711 An exempt reporting adviser is an investment adviser that relies on the exemption from investment adviser registration provided in either section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds or 203(m) of the Advisers Act because it is an adviser solely to private funds and has assets under management in the United States of less than $150 million. An exempt reporting adviser is not a registered investment adviser and therefore would not be subject to the relationship summary requirements.

712 Based on responses to Item 5.D. of Form ADV. These advisers indicated that they advise either high net worth individuals or individuals (other than high net worth individuals), which includes trusts, estates, and 401(k) plans and IRAs of individuals and their family members, but does not include businesses organized as sole proprietorships. The proposed definition of retail investor would include a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust. We are not able to determine, based on responses to Form ADV, exactly how many advisers provide investment advice to these types of trusts or other entities; however, we believe that these advisers most likely also advise individuals and are therefore included in our estimate.

713 12,721 registered investment advisers—7,625 = 5,096 registered investment advisers not providing advice to retail investors.

714 Based on IARD system data.

715 *See supra* note 457.

716 *See* Form ADV and Investment Advisers Act Rules, Final Rule, Investment Advisers Act Release No. 4509 (Aug. 25, 2016) [81 FR 60418 (Sep. 1, 2016)] (''2016 Form ADV Paperwork Reduction Analysis'').

717 363,082 hours/(12,024 registered advisers + 3,248 exempt reporting advisers) = 23.77 hours.

718 $92,404,369 hours/(12,024 registered advisers + 3,248 exempt reporting advisers) = $6,051.

719 *See* 2016 Form ADV Paperwork Reduction Analysis, *supra* note 716, at 81 FR 60454.

equivalent limit if in electronic format). Thus, while we recognize that different firms may require different amounts of time to prepare the relationship summary, we believe that this is an appropriate average number for estimating an aggregate amount for the industry for purposes of the PRA analysis. Moreover, a considerable amount of language within each topic area also would be prescribed, thereby limiting the amount of time required to prepare the relationship summary. Based on these factors, we believe that the estimate of five hours to prepare and file the relationship summary is appropriate. We therefore estimate that the total burden of preparing and filing the relationship summary would be 38,125 hours.[720] As with the Commission's prior Paperwork Reduction Act estimates for Form ADV, we believe that most of the paperwork burden would be incurred in advisers' initial preparation and submission of Part 3: Form CRS, and that over time this burden would decrease substantially because the paperwork burden would be limited to updating information.[721] As under the currently approved collection, the estimated initial burden associated with preparing the relationship summary would be amortized over the estimated period that advisers would use the relationship summary, *i.e.,* over a three-year period.[722] The annual hour burden of preparing and filing the relationship summary would therefore be 12,708.[723] In addition, based on IARD system data, the Commission assumes that 1,000 new investment advisers will file Form ADV with us annually. Of these, we estimate that 477 would be required to prepare and file the relationship summary.[724] Therefore, the aggregate initial burden for newly registered advisers to prepare the relationship summary would be 2,385 [725] and, amortized over three years, 795 on an annual basis.[726] In sum, the annual hour burden for existing and newly registered investment advisers to prepare and file a relationship summary would be 13,503 hours,[727] or 1.67 hours per adviser.[728]

b. Estimated External Costs for Investment Advisers Preparing the Relationship Summary

The currently approved total annual collection of information burden estimate for Form ADV anticipates that there will be external costs, including (i) a one-time initial cost for outside legal and compliance consulting fees in connection with the initial preparation of Part 2 of Form ADV, and (ii) the cost for investment advisers to private funds to report the fair value of their private fund assets.[729] We do not anticipate that the amendments we are proposing today will affect the per adviser cost burden for those existing requirements but anticipate that some advisers may incur a one-time initial incremental cost for outside legal and consulting fees in connection with the initial preparation of the relationship summary. We do not anticipate external costs to investment advisers in the form of website set-up, maintenance, or licensing fees because they would not be required to establish a website for the sole purpose of posting their relationship summary if they do not already have a website. We also do not expect other ongoing external costs for the relationship summary. Although advisers would be required to amend the relationship summary within 30 days whenever any information becomes materially inaccurate, given the standardized nature and prescribed language of the relationship summary, we expect that amendments would be factual and require relatively minimal wording changes. We believe that the investment adviser would be more knowledgeable about these facts than outside legal or compliance consultants and would be able to make these revisions in-house. Therefore, we do not expect that investment advisers will need to incur ongoing external costs for the preparation and review of relationship summary amendments. Although advisers that would be subject to the relationship summary requirement may vary widely in terms of the size, complexity and nature of their advisory business, we believe that the amount of disclosure required would not vary substantially among advisers. Accordingly, we believe that the amount of time, and thus cost, required for outside legal and compliance review is unlikely to vary substantially among those advisers who elect to obtain outside assistance.[730]

Most of the information proposed to be required in the relationship summary is readily available to investment advisers from Form ADV Part 2, and the narrative descriptions are narrowly tailored and brief or prescribed. As a result, we anticipate that a quarter of advisers will seek the help of outside legal services and half will seek the help of compliance consulting services in connection with the initial preparation of the relationship summary. We estimate that the initial per existing adviser cost for legal services related to the preparation of the relationship summary would be $1,416.[731] We estimate that the initial per existing adviser cost for compliance consulting services related to the preparation of the relationship summary would be $2,109.[732] Thus, the incremental external cost burden for existing investment advisers is estimated to be $10,739,813, or $3,579,938 annually when amortized over a three-year

[720] 5.0 hours × 7,625 investment advisers = 38,125 total aggregate initial hours.

[721] We discuss the burden for advisers making annual updating amendments to Form ADV in Section V.A.3 below.

[722] *See* 2016 Form ADV Paperwork Reduction Analysis, *supra* note 716.

[723] 5.0 hours × 7,625 investment advisers/3 = 12,708 total annual aggregate hours.

[724] The number of new investment advisers is calculated by looking at the number of new advisers in 2016 and 2017 and then determining the number each year that serviced retail investors. (455 for 2016 + 499 for 2017)/2 = 477.

[725] 477 new RIAs required to prepare relationship summary × 5.0 hours = 2,385 hours for new RIAs to prepare relationship summary.

[726] 477 × 5.0 hours/3 = 795.

[727] (38,125 + 2,385)/3 years = 13,503 annual hour burden for existing and new advisers to prepare and file relationship summary.

[728] 13, 503 hours/(7,625 existing advisers + 477 new advisers) = 1.67 hours per year.

[729] *See* 2016 Form ADV Paperwork Reduction Analysis, *supra* note 716, at 81 FR 60452. We do not anticipate that the amendments we are proposing to add Form ADV Part 3 will affect those per adviser cost burden estimates for outside legal and compliance consulting fees. The estimated external costs of outside legal and consulting services for the relationship summary are in addition to the estimated hour burden discussed above.

[730] We estimate that an external service provider would spend 3 hours helping an adviser prepare an initial relationship summary. In estimating the external cost for the initial preparation of Form ADV Part 2, we estimated that small, medium, and large advisers would require 8, 11, and 26 hours of outside assistance, respectively, to prepare Form ADV Part 2. In comparison, as discussed above, the relationship summary is limited to four pages in length (or equivalent limit if in electronic format) and is standardized across investment advisers in terms of the mandated selection and sequence of topic areas. While we recognize that different firms may require different amounts of external assistance in preparing the relationship summary, we believe that this is an appropriate average number for estimating an aggregate amount for the industry purposes of the PRA analysis. *See* Brochure Adopting Release, *supra* note 157, at 75 FR at 49257.

[731] External legal fees are in addition to the projected hour per adviser burden discussed above. $472 per hour for legal services × 3 hours per adviser = $1,416. The hourly cost estimate of $472 is based on an inflation-adjusted figure and our consultation with advisers and law firms who regularly assist them in compliance matters.

[732] External compliance consulting fees are in addition to the projected hour per adviser burden discussed above. Data from the SIFMA Management and Professional Earnings Report, modified to account for an 1,800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, and adjusted for inflation (''SIFMA Management and Professional Earnings Report''), suggest that outside management consulting services cost approximately $703 per hour. $703 per hour for outside consulting services × 3 hours per adviser = $2,109.

period.[733] In addition, we assume that 1,000 new advisers will register with us annually, 477 of which would be required to prepare a relationship summary. For these 477 new advisers, we estimate that they will require $671,855 in external costs to prepare the relationship summary.[734] In summary, the annual external legal and compliance consulting cost for existing and new advisers relating to relationship summary obligations is estimated to total $4,251,792, or $525 per adviser.[735]

c. Amendments to the Relationship Summary and Filing of Amendments

The current approved information collection burden for Form ADV also includes the hour burden associated with annual and other amendments to Form ADV, among other requirements. We anticipate that the proposed relationship summary would increase the annual burden associated with Form ADV by 0.5 hours [736] due to amendments to the relationship summary,[737] for those advisers required to prepare and file a relationship summary. We do not expect amendments to be frequent, but based on the historical frequency of amendments made on Form ADV Parts 1 and 2, estimate that on average, each adviser preparing a relationship summary will likely amend the disclosure an average of 1.80 times per year.[738] The collection of information burden of 0.5 hours for amendments to the relationship summary would include filing it. Based on the number of other-than-annual amendments filed by investment advisers with retail investors last year, we estimate that advisers will file an estimated total of 1.80 [739] relationship summary amendments per year for an estimated total paperwork burden of 6,878 hours per year.[740]

d. Incremental Increase to Form ADV Hourly and External Cost Burdens Attributable to Proposed Amendments

For existing and newly-registered advisers with relationship summary obligations, the additional burden attributable to amendments to Form ADV to add Part 3: Form CRS, (including the initial preparation and filing of the relationship summary and amendments thereto) totals 20,381 hours,[741] or 2.52 hours per adviser,[742] and a monetized cost of $5,248,193, or $648 per adviser.[743] The incremental external legal and compliance cost is estimated to be $4,251,792.[744]

3. Total Revised Burden Estimates for Form ADV

a. Revised Hourly and Monetized Value of Hourly Burdens

As discussed above, the currently approved total aggregate annual hour burden for all registered advisers completing, amending, and filing Form ADV (Part 1 and Part 2) with the Commission is 363,082 hours, or a blended average per adviser burden of 23.77 hours, with a monetized cost of $92,404,369, or $6,051 per adviser. This includes the total annual hour burden for registered advisers of 351,386 hours, or 29.22 hours per registered adviser, and 11,696 hours for exempt reporting advisers, or 3.60 hours per exempt reporting adviser. For purposes of updating the total information collection based on the proposed amendments to Form ADV, we consider three categories of respondents, as noted above: (i) Existing and newly-registered advisers preparing and filing a relationship summary, (ii) registered advisers with no obligation to prepare and file a relationship summary, and (iii) exempt reporting advisers.

For existing and newly-registered advisers preparing and filing a relationship summary, including amendments to the disclosure, the total annual collection of information burden for preparing all of Form ADV, updated to reflect the proposed amendments to Form ADV, equals 31.74 hours per adviser, with 2.52 hours attributable to the proposed amendments.[745] On an aggregate basis, this totals 257,122 hours for existing and newly registered advisers, with a monetized value of $66,208,857.[746]

As noted above, we estimate 5,096, or approximately 40% of existing registered advisers, would not have retail investors; therefore, they would not be obligated to prepare and file relationship summaries, so their annual per adviser hour burden would remain unchanged.[747] To that end, using the currently approved total annual hour estimate of 29.22 hours per registered investment adviser to prepare and amend Form ADV, we estimate that the updated annual hourly burden for all existing and newly-registered investment advisers not required to prepare a relationship summary would be 164,187,[748] with a monetized value

[733] 25% × 7,625 existing advisers × $1,416 for legal services = $2,699,250 for legal services. 50% × 7,625 existing advisers × $2,109 for compliance consulting services = $8,040,563. $2,699,250 + $8,040,563 = $10,739,813 in external legal and compliance consulting costs for existing advisers. $10,739,813/3 = $3,579,938 annually.

[734] 25% × 477 new advisers × $1,416 for legal services = $168,858. 50% × 477 new advisers × $2,109 for compliance consulting services = $502,997. $168,858 + $502,997 = $671,855 annually in external legal and compliance consulting costs for newly registered advisers.

[735] $3,579,938 in external legal and compliance consulting costs for existing advisers + $671,855 for new advisers = $4,251,792 annually for existing and new advisers. $4,251,792/($7,625 existing advisers + 477 new advisers) = $525 per adviser.

[736] We have previously estimated that investment advisers would incur 0.5 hours to prepare an interim (other-than-annual) amendment to Form ADV. *See* 2016 Form ADV Paperwork Reduction Analysis, *supra* note 716, at 81 FR at 60452. We believe that an amendment to the relationship summary would take a similar amount of time, if not less.

[737] Similarly, we estimated that 0.5 hours would be required for interim updating amendments to Form ADV Part 2. *See* Brochure Adopting Release, *supra* note 157, at 75 FR at 49257.

[738] This estimate is based on IARD system data regarding the number of filings of Form ADV amendments.

[739] Based on IARD data, 7,625 investment advisers with retail clients filed 13,756 other-than-annual amendments to Form ADV. 13,756 other-than-annual amendments/7,625 investment advisers = 1.80 amendments per investment adviser.

[740] 7,625 investment advisers amending relationship summaries × 1.80 amendments per year × 0.5 hours = 6,878 hours.

[741] 13,503 hours for initial preparation and filing of the relationship summary + 6,878 hours for amendments to the relationship summary = 20,381 total aggregate annual hour burden attributable to the Form ADV amendments to add Part 3: Form CRS.

[742] 20,381 hours/(7,625 existing advisers + 477 newly registered advisers) = 2.52 hours per adviser.

[743] 20,381 total aggregate annual hour burden for preparing and filing a relationship summary. We expect that performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the SIFMA Management and Professional Earnings Report suggest that costs for these positions are $229 and $298 per hour, respectively. 20,381 hours × 0.5 × $229 = $2,211,375. 20,381 hours × 0.5 × $298 = $3,036,819. $2,211,375 + $3,036,819 = $5,248,193. $5,248,193/(7,625 existing registered advisers + 477 newly registered advisers) = $648 per adviser.

[744] *See supra* note 735.

[745] 29.22 hours + 2.52 hours for increase in burden attributable to initial preparation and filing of, and amendments to, relationship summary = 31.74 hours total.

[746] 31.74 hours × 7,625 existing RIAs required to prepare a relationship summary + 477 newly registered RIAs required to prepare a relationship summary = 257,122 total aggregate annual hour burden for preparing, filing and amending a relationship summary. We expect that performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the SIFMA Management and Professional Earnings Report suggest that costs for these positions are $229 and $298 per hour, respectively. 257,122 hours × 0.5 × $229 = $27,897,712. 257,122 hours × 0.5 $298 = $38,311,144. $27,897,712 + $38,311,144 = $66,208,857.

[747] 12,721 registered investment advisers—7,625 registered investment advisers with retail investors = 5,096 registered investment advisers without retail investors.

[748] 29.22 hours × (5,096 existing and 523 newly-registered investment advisers without retail investors) = approximately 164,187 total annual hour burden for RIAs not preparing a relationship summary.

of $43,263,322.[749] The revised total annual collection of information burden for exempt reporting advisers, using the currently approved estimate of 3.60 hours per exempt reporting adviser, would be 15,653 hours,[750] for a monetized cost of $4,124,513, or $949 per exempt reporting adviser.[751]

In summary, factoring in the proposed amendments to Form ADV to add Part 3, the revised aggregate burden for Form ADV for all registered advisers and exempt reporting advisers would be 436,962,[752] for a monetized cost of $115,139,422.[753] This results in a blended average per adviser burden for Form ADV of 26.37 hours [754] and $6,949 per adviser.[755] This is an increase of 73,880 hours, [756] or $22,735,053 [757] in the monetized value of the hour burden, from the currently approved annual aggregate burden estimates, increases which are attributable primarily to the proposed burden estimates on the larger registered investment adviser and exempt reporting adviser population since the most recent approval, adjustments for inflation, and the amendments to Form ADV.

b. Revised Estimated External Costs for Form ADV

The currently approved total annual collection of information burden estimate for Form ADV anticipates that there will be external costs, including (i) a one-time initial cost for outside legal and compliance consulting fees in connection with the initial preparation of Part 2 of Form ADV, and (ii) the cost for investment advisers to private funds to report the fair value of their private fund assets.[758] The currently approved annual cost burden for Form ADV is $13,683,500, $3,600,000 of which is attributable to external costs incurred by new advisers to prepare Form ADV Part 2, and $10,083,500 of which is attributable to obtaining the fair value of certain private fund assets.[759] We do not expect any change in the annual external costs relating to new advisers preparing Form ADV Part 2. Due to the slightly higher number of registered advisers with private funds, however, the cost of obtaining the fair value of private fund assets may be higher. We estimate that 6% of registered advisers have at least one private fund client that may not be audited. Based on IARD system data as of December 31, 2017, 4,670 registered advisers advise private funds. We therefore estimate that approximately 281 registered advisers may incur costs of $37,625 each on an annual basis, for an aggregate annual total cost of $10,572,625.[760]

In summary, taking into account (i) a one-time initial cost for outside legal and compliance consulting fees in connection with the initial preparation of Part 2 of Form ADV, (ii) the cost for investment advisers to private funds to report the fair value of their private fund assets, and (iii) the incremental external legal or compliance costs for the preparation of the proposed relationship summary, we estimate the annual aggregate external cost burden of the Form ADV information collection would be $18,424,417, or $1,448 per registered adviser.[761] This represents a $4,740,917 increase from the current external costs estimate for the information collection.[762]

B. Rule 204–2 Under the Advisers Act

Under section 204 of the Advisers Act, investment advisers registered or required to register with the Commission under section 203 of the Advisers Act must make and keep for prescribed periods such records (as defined in section 3(a)(37) of the Exchange Act), furnish copies thereof, and make and disseminate such reports as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 204–2 sets forth the requirements for maintaining and preserving specified books and records. We are proposing amendments to rule 204–2 that would require registered advisers to retain copies of each relationship summary. Investment advisers would also be required to maintain each amendment to the relationship summary as well as to make and preserve a record of dates that each relationship summary and each amendment was delivered to any client or to any prospective client who subsequently becomes a client, as well as to any retail investor before such retail investor opens an account. These records would be required to be maintained in the same manner, and for the same period of time, as other books and records required to be maintained under rule 204–2(a), to allow regulators to access the relationship summary during an examination. Specifically, investment advisers would be required to maintain and preserve a record of the relationship summary in an easily accessible place for not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in an appropriate office of the investment adviser. This collection of information is found at 17 CFR 275.204–2 and is mandatory. The Commission staff uses the collection of information in its examination and oversight program. Requiring maintenance of these disclosures as part of the firm's books and records would facilitate the Commission's ability to inspect for and enforce compliance with firms' obligations with respect to Form CRS.

[749] We expect that performance of this function for registered advisers will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the 2018 SIFMA Management and Professional Earnings Report suggest that costs for these positions are $229 and $298 per hour, respectively. 164,187 hours × 0.5 × $229 = $18,799,432. 164,187 hours × 0.5 × $298 = $24,463,890. $18,799,432 + $24,463,890 = $43,263,322.

[750] 3.60 hours × 3,848 exempt reporting advisers currently + 500 new exempt reporting advisers = 15,653 hours.

[751] As with preparation of the Form ADV for registered advisers, we expect that performance of this function for exempt reporting advisers will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the 2018 SIFMA Management and Professional Earnings Report suggest that costs for these positions are $229 and $298 per hour, respectively. 15,653 hours × 0.5 × $229 = $1,792,246. 15,653 hours × 0.5 × $298 = $2,322,267. $1,792,246 + $2,322,267 = $4,124,513. $4,124,513/(3,848 exempt reporting advisers currently + 500 new exempt reporting advisers) = $949 per exempt reporting adviser.

[752] 257,122 annual hour burden for RIAs preparing relationship summary + 164,187 annual hour burden for RIAs not preparing relationship summary + 15,653 annual hour burden for exempt reporting advisers = 436,962 total updated Form ADV annual hour burden.

[753] $66,208,857 for RIAs preparing relationship summary + $43,263,890 for RIAs not preparing relationship summary + $4,124,513 for exempt reporting advisers = $115,139,422 total updated Form ADV annual monetized hourly burden.

[754] 436,962/(12,721 registered investment advisers + 3,843 exempt reporting advisers) = 26.37 hours per adviser.

[755] $115,139,422/12,721 registered investment advisers + 3,843 exempt reporting advisers) = $6,949 per adviser.

[756] 436,962 hours estimated—363,082 hours currently approved = 73,880 hour increase in aggregate annual hourly burden.

[757] $115,139,422 monetized hourly burden − $92,404,369 = $22,735,053 increase in aggregate annual monetized hourly burden.

[758] *See* 2016 Form ADV Paperwork Reduction Analysis, *supra* note 716, at 81 FR 60452. We do not anticipate that the amendments we are proposing to add to Form ADV Part 3 will affect those per adviser cost burden estimates for outside legal and compliance consulting fees. The estimated external costs of outside legal and compliance consulting services for the relationship summary are in addition to the estimated hour burden discussed above.

[759] *See* 2016 Form ADV Paperwork Reduction Analysis, *supra* note 716, at 81 FR at 60452–53. The $10,083,500 is based on 4,469 registered advisers reporting private fund activity as of May 16, 2016.

[760] 6% × 4,760 = 281 advisers needing to obtain the fair value of certain private fund assets. 281 advisers × $37,625 = $10,572,625.

[761] $3,600,000 for preparation of Form ADV Part 2 + $10,572,625 for registered investment advisers to fair value their private fund assets + $4,251,792 to prepare relationship summary = $18,424,417 in total external costs for Form ADV. $18,424,417/12,721 total registered advisers as of December 31, 2017 = $1,448 per registered adviser.

[762] $18,424,417 − $13,683,500 = $4,740,917.

The information generally is kept confidential.[763]

The likely respondents to this collection of information are all of the approximately 12,721 advisers currently registered with the Commission. We estimate that based on updated IARD data as of December 31, 2017, 7,625 existing advisers will be subject to the amended provisions of rule 204–2 to preserve the relationship summary as a result of the proposed amendments.

1. Changes in Burden Estimates and New Burden Estimates

The approved annual aggregate burden for rule 204–2 is currently 2,199,791 hours, with a total annual aggregate monetized cost burden of approximately $130,316,112, based on an estimate of 12,024 registered advisers, or 183 hours per registered adviser.[764] We estimate that the proposed amendments would result in an increase in the collection of information burden estimate by 0.2 hours[765] for each of the estimated 7,625 registered advisers with relationship summary obligations,[766] resulting in a total of 183.2 hours per adviser. This would yield an annual estimated aggregate burden of 1,396,900 hours under amended rule 204–2 for all registered advisers with relationship summary obligations,[767] for a monetized cost of $85,476,311.[768] In addition, the 5,096 advisers[769] not subject to the proposed amendments would continue to be subject to an unchanged burden of 183 hours under rule 204–2, or a total aggregate annual hour burden of 932,568,[770] for a monetized cost of $57,063,836.[771] In summary, taking into account the estimated annual burden of registered advisers that would be required to maintain records of the relationship summary, as well as the estimated annual burden of registered advisers that do not have relationship summary obligations and whose information collection burden is unchanged, the revised annual aggregate burden for all respondents to rule 204–2, under the proposed amendments, would be estimated to be 2,329,468 total hours,[772] for a monetized cost of $142,540,147.[773]

2. Revised Annual Burden Estimates

As noted above, the approved annual aggregate burden for rule 204–2 is currently 2,199,791, hours based on an estimate of 12,024 registered advisers, or 183 hours per registered adviser.[774] The revised annual aggregate hourly burden for rule 204–2 would be 2,329,468[775] hours, represented by a monetized cost of $142,540,147,[776] based on an estimate of 7,625 registered advisers with the relationship summary obligation and 5,096 registered advisers without, as noted above. This represents an increase of 129,677[777] annual aggregate hours in the hour burden and an annual increase of $12,224,035 from the currently approved total aggregate monetized cost for rule 204–2.[778] These increases are attributable to a larger registered investment adviser population since the most recent approval and adjustments for inflation, as well as the proposed rule 204–2 amendments relating to the relationship summary as discussed in this proposing release.

C. Rule 204–5 Under the Advisers Act

Proposed new rule 204–5 would require an investment adviser to deliver the relationship summary to each retail investor before or at the time the adviser enters into an investment advisory agreement (even if the adviser's agreement with the retail investor is oral) as well as to existing clients one time within a specified time period after the effective date of the proposed amendments. The adviser also would deliver the relationship summary to existing clients before or at the time (i) a new account is opened that is different from the retail investor's existing account(s); or (ii) changes are made to the retail investor's existing account(s) that would materially change the nature and scope of the adviser's relationship with the retail investor, as further discussed in Section II.C.2 above. In addition, advisers would be required to post a current version of their relationship summary prominently on their public website (if they have one). Investment advisers would be required to communicate any changes in an updated relationship summary to retail investors who are existing clients or customers of the firm within 30 days after the updates are required to be made and without charge. The communication can be made by delivering the relationship summary or by communicating the information in another way to the retail investor.

Proposed new rule 204–5 contains a collection of information requirement. The collection of information is necessary to provide advisory clients, prospective clients and the Commission with information about the investment adviser and its business, conflicts of interest and personnel. Clients would use the information contained in the relationship summary to determine whether to hire or retain an investment adviser and what type of accounts and services are appropriate for their needs. The Commission would use the information to determine eligibility for registration with us and to manage our regulatory and examination programs. This collection of information would be found at 17 CFR 275.204–5 and would be mandatory. Responses would not be kept confidential.

1. Respondents: Investment Advisers

The likely respondents to this information collection would be the approximately 7,625 investment

[763] *See* section 210(b) of the Advisers Act (15 U.S.C. 80b–10(b)).

[764] *See* 2016 Form ADV Paperwork Reduction Analysis, *supra* note 716, at 81 FR at 60454–55.

[765] In the Paperwork Reduction Act analysis for amendments to Form ADV adopted in 2016, we estimated that 1.5 hours would be required for each adviser to make and keep records relating to (i) the calculation of performance the adviser distributes to any person and (ii) all written communications received or sent relating to the adviser's performance. Because the burden of preparing of the relationship summary is already included in the collection of information estimates for Form ADV, and because the relationship is a short, standardized document, we assume that recordkeeping burden for the relationship summary would be considerably less than 1.5 hours and estimate that 0.2 hours would be appropriate.

[766] *See supra* note 674.

[767] 7,625 registered investment advisers required to prepare relationship summary × 183.2 hours = 1,396,900 hours.

[768] As with our estimates relating to the previous amendments to rule 204–2 (*see* 2016 Form ADV Paperwork Reduction Analysis, *supra* note 716, at 81 FR at 60454–55, we expect that performance of this function will most likely be allocated between compliance clerks and general clerks, with compliance clerks performing 17% of the function and general clerks performing 83% of the function. Data from the SIFMA Office Salaries in the Securities Industry Report, modified to account for an 1,800-hour work year and multiplied by 2.93 to account for bonuses, firm size, employee benefits, and overhead (''SIFMA Office Salaries Report), suggest that costs for these positions are $67 and $60, respectively. (17% × 1,396,9001 hours × $67) + (83% × 1,396,900 hours × $60) = $85,476,311.

[769] *See supra* note 681.

[770] 5,096 registered investment advisers not required to prepare the relationship summary × 183 hours = 932,568.

[771] As with our estimates relating to the previous amendments to rule 204–2 (*see* 2016 Form ADV Paperwork Reduction Analysis, *supra* note 716, at 81 FR at 60454–55, we expect that performance of this function will most likely be allocated between compliance clerks and general clerks, with compliance clerks performing 17% of the function and general clerks performing 83% of the function. Data from the SIFMA Office Salaries Report suggest that costs for these positions are $67 and $60, respectively. (17% × 932,568 hours × $67) + (83% × 932,568 hours × $60) = $57,063,836.

[772] 7,625 registered investment advisers required to prepare relationship summary × 183.2 hours = 1,396,900 hours. 5,096 registered investment advisers not required to prepare the relationship summary × 183 hours = 932,568 hours. 1,396,900 hours + 932,568 hours = 2,329,468 hours.

[773] $85,476,311 + $57,063,836 = $142,540,147.

[774] 2,199,791 hours/12,024 registered advisers = 183 hours per adviser.

[775] *See supra* note 772.

[776] *See supra* note 773.

[777] 2,329,467 hours − 2,199,791 hours = 129,677 hours.

[778] $142,540,073 − $130,316,112 = $12,224,035.

advisers registered with the Commission that would be required to deliver a relationship summary per proposed new rule 204–5. We also note that these figures include the 366 registered broker-dealers that are dually registered as investment advisers.[779]

2. Initial and Annual Burdens

a. Posting of the Relationship Summary to Website

Under proposed new rule 204–5, advisers would be required to post a current version of their relationship summary prominently on their public website (if they have one). We estimate that each adviser would incur 0.5 hours to prepare the relationship summary, such as to ensure proper electronic formatting, and to post the disclosure to the adviser's website, if the adviser has one.[780] Based on IARD system data, 91.1% of investment advisers with individual clients report at least one public website. Therefore, we estimate that 91.1% of the 7,625 existing and 477 newly-registered investment advisers with relationship summary obligations would incur a total of 3,690 aggregate burden hours to post relationship summaries to their websites,[781] with a monetized cost of $221,428.[782] As with the initial preparation of the relationship summary, we amortize the estimated initial burden associated with posting the relationship summary over a three-year period.[783] Therefore, the total annual aggregate hourly burden related to the initial posting of the relationship summary is estimated to be 1,230 hours, with a monetized cost of $73,809.[784] We do not anticipate external costs to rule 204–5 because investment advisers without a public website would not be required to establish or maintain one. External costs for the preparation of the relationship summary are already included for the collection of information estimates for Form ADV, in Section V.A, above.

b. Delivery to Existing Clients

i. One-Time Initial Delivery to Existing Clients

The burden for this proposed rule is based on each adviser with retail investors having, on average, an estimated 4,461 clients who are retail investors.[785] Although advisers may either deliver the relationship summary separately, in a ''bulk delivery'' to clients, or as part of the delivery of information that advisers already provide, such as the annual Form ADV update, account statements or other periodic reports, we base our estimates here on a ''bulk delivery'' to existing clients. This is similar to the approach we took in estimating the delivery costs for amendments to rule 204–3 under the Advisers Act, which requires investment advisers to deliver their Form ADV Part 2 brochures and brochure supplements to their clients.[786] As with the estimates for rule 204–3, we estimate that advisers would require approximately 0.02 hours to deliver the relationship summary to each client.[787] Based on IARD data as of December 31, 2017, we estimate that advisers with the obligation to deliver the relationship summary under proposed rule 204–5 have, on average, 4,461 clients who are retail investors, per adviser. Thus, we estimate the total burden hours for 7,625 advisers for initial delivery of the relationship to existing clients to be 89.22 hours per adviser, or 722,860 total aggregate hours, for the first year after the rule is in effect,[788] with a monetized cost of $5,353[789] per adviser or $43,339,507 in aggregate.[790] Amortized over three years, the total annual hourly burden is estimated to be 29.74 hours per adviser, or 240,953 annual hours in aggregate,[791] with annual monetized costs of $1,784 per adviser, or $14,457,209 in aggregate.[792] We do not expect that investment advisers will incur external costs for the initial delivery of the relationship summary to existing clients because we assume that advisers will make such deliveries along with another required delivery, such as an interim or annual update to the Form ADV Part 2.

ii. Delivery for New Account Types or Material Changes in the Nature or Scope of the Advisory Relationship

As noted above, investment advisers also would be required to deliver the relationship summary to existing clients before or at the time (i) a new account is opened that is different from the retail investor's existing account(s); or (ii) changes are made to the retail investor's existing account(s) that would materially change the nature and scope of the adviser's relationship with the retail investor, as further discussed in Section II.C.2. With respect to delivery of the relationship summary in the event new account types are opened or material changes occur in the nature or scope of the advisory relationship, we expect that such delivery would take place among 10% of an adviser's retail investors annually. We would therefore estimate a total annual hourly burden of 9 hours per adviser and 72,286 hours in total annual aggregate hours,[793] with a monetized cost of $535 per adviser[794]

[779] *See supra* note 457 and accompanying text.

[780] This estimate is based upon staff experience. *See e.g.,* Enhanced Mutual Fund Disclosure Adopting Release, *supra* note 47 (''we estimate, as we did in the proposing release, that rule 498 will impose a ½ hour burden per portfolio annually associated with the compilation of the additional information required on a cover page or at the beginning of the Summary Prospectus. Rule 498 also imposes annual hour burdens associated with the posting of a fund's Summary Prospectus, statutory prospectus, SAI, and most recent report to shareholders on an Internet website. We estimate that the average hour burden for one portfolio to comply with the Internet website posting requirements will be approximately one hour annually.'') Because rule 204–5 pertains to one document, the relationship summary, which is much shorter than the several documents to which rule 498 applies, we estimate that each adviser on average would incur approximately 0.5 hours for the preparation of the relationship summary for posting, and for the posting itself.

[781] 0.5 hours to prepare and post the relationship summary × 91.1% × (7,625 existing advisers + 477 newly-registered advisers with relationship summary obligations) × 0.5 hours = 3,690 hours.

[782] Based on data from the SIFMA Office Salaries Report, we expect that requirement for investment advisers to post their relationship summaries to their websites will most likely be performed by a general clerk at an estimated cost of $60 per hour. 0.5 hours per adviser × $60 = $30 in monetized costs per adviser. $30 per adviser × (7,625 existing advisers + 477 newly registered advisers = $221,428 total aggregate monetized cost.

[783] *See* 2016 Form ADV Paperwork Reduction Analysis, *supra* note 716.

[784] 43,688 hours/3 years = 1,230 hours annually. $221,428/3 years = $73,809 in annualized monetized costs.

[785] Based on IARD system data as of December 31, 2017.

[786] *See* Brochure Adopting Release, *supra* note 157, at 75 FR at 49259.

[787] This is the same estimate we made in the Form ADV Part 2 proposal and for which we received no comment. Brochure Adopting Release, *supra* note 157, at 75 FR at 49259 We note that the burden for preparing relationship summaries is already incorporated into the burden estimate for Form ADV discussed above.

[788] (0.02 hours per client × 4,461 retail clients per adviser) = 89.22 hours per adviser. 89.22 hours per adviser × (7,625 existing advisers + 477 newly registered advisers) = 722,860 total aggregate hours.

[789] Based on data from the SIFMA Office Salaries Report, we expect that initial delivery requirement to existing clients of rule 204–5 will most likely be performed by a general clerk at an estimated cost of $60 per hour. 89.22 hours per adviser × $60 = $5,353 in monetized costs per adviser. We estimate that advisers will not incur any incremental postage costs because we assume that they will make such deliveries with another mailing the adviser was already delivering to clients, such as interim or annual updates to the Form ADV, or will deliver the relationship summary electronically.

[790] $5,353 in monetized costs per adviser × (7,625 existing advisers + 477 newly registered advisers) = $43,339,507 in total aggregate costs.

[791] 89.22 initial hours per adviser/3 = 29.74 total annual hours per adviser. 722,860 initial aggregate hours/3 = 240,953 total annual aggregate hours.

[792] $5,353 in monetized costs per adviser/3 = $1,784 annualized monetized cost per adviser. $43,339,507 initial aggregate monetized cost/3 = $14,14,457,209 in total annual aggregate monetized cost.

[793] 10% of 4,461 retail clients per adviser × .02 hours to deliver the relationship summary = 9 hours per adviser. 9 hours × (7,625 existing advisers + 477 new advisers) = 72,286 total aggregate hours.

[794] Based on data from the SIFMA Office Salaries Report, we expect that delivery requirements of rule

Continued

and $4,337,163 in aggregate.[795] We do not expect advisers to incur external costs related to deliveries of the relationship summary due to new account type openings, or material changes to the nature or scope of the relationship, because we assume that advisers will deliver the relationship summary along with new account agreements and other information normally required in such circumstances.

iii. Posting of Amended Relationship Summaries to Websites and Communicating Changes to Amended Relationship Summaries, Including by Delivery

Investment advisers would be required to amend their relationship summaries within 30 days when any of the information becomes materially inaccurate. We do not expect amendments to be frequent, but based on the historical frequency of amendments made on Form ADV Parts 1 and 2, estimate that on average, each adviser preparing a relationship summary will likely amend the disclosure and average of 1.81 times per year.[796] As above, we estimate that preparation of the relationship summary for posting to the web and the posting itself will require 0.5 hours. Therefore, once again using the same percentage of investment advisers reporting public websites, 91.1% of 7,625 advisers would incur a total annual burden of 0.91 hours per adviser, or 6,286 hours in aggregate,[797] to post the amended relationship summaries to their website. This translates into an annual monetized cost of $54.30 per adviser, or $377,188 in the aggregate for existing registered advisers with relationship summary obligations.[798] Investment advisers also will be required to communicate any changes in an amended relationship summary to existing clients who are retail investors. The communication can be made by delivering the relationship summary or by communicating the information in another way. For this requirement, we estimate that 50% of advisers will choose to deliver the relationship summary to communicate the updated information, and that the delivery will be made along with other disclosures already required to be delivered, such as an interim or annual Form ADV update. We therefore estimate a burden of 615,674 [799] hours, or 161.5 hours per adviser,[800] at a monetized cost of $36,940,426 in aggregate,[801] or $9,689 per adviser,[802] for the 50% of advisers that choose to deliver amended relationship summaries in order to communicate updated information. Similar to the other delivery requirements discussed above for proposed rule 204–5, we do not expect investment advisers to incur external costs in delivering amended relationship summaries because we assume that they will make this delivery with other disclosures required to be delivered, such as an interim or annual update to Form ADV.

c. Delivery to New Clients or Prospective New Clients

Data from the IARD system indicate that of the 12,721 advisers registered with the Commission, 7,625 have retail investors, and on average, each has 4,461 clients who are retail investors.[803] Based on IARD system data from 2015 to 2017, we estimate that the client base for investment advisers will grow by approximately 4.5% annually.[804] Based on our experience with Form ADV Part 2, we estimate the annual hour burden for initial delivery of a relationship summary would be the same by paper or electronic format, at 0.02 hours for each relationship summary,[805] or 4 annual hours per adviser.[806] Therefore, we estimate that the aggregate annual hour burden for initial delivery of the relationship summary to new clients would be 30,614 hours,[807] at a monetized cost of $1,836,817, or $241 per adviser.[808] We do not expect that advisers will incur external costs to deliver the relationship summary to new or prospective clients because we assume that advisers will make the delivery along with other documentation normally provided in such circumstances, such as Form ADV Part 2, or will deliver the relationship summary electronically.

d. Total New Initial and Annual Burdens

Altogether, we estimate the total collection of information burden for proposed new rule 204–5 to be 967,044 annual aggregate hours per year,[809] or

204–5 will most likely be performed by a general clerk at an estimated cost of $60 per hour. 9 hours per adviser × $60 = $535 per adviser. We estimate that advisers will not incur any incremental postage costs in the delivery of the relationship summary to existing clients for changes in accounts, because we assume that advisers will make such deliveries with another mailing the adviser was already delivering to clients, such as new account agreements and other documentation normally required in such circumstances.

[795] $535 in monetized costs per adviser × (7,625 existing advisers + 477 newly registered advisers) = $4,337,163 in total aggregate costs.

[796] This estimate is based on IARD system data regarding the number of filings of Form ADV amendments. *See also supra* note 702 and accompanying text.

[797] 0.5 hours to post the amendment × 1.81 amendments annually = 0.91 hours per adviser annually to post amendments to the website. 0.91 × 7,625 existing advisers amending the relationship summary × 91.1% of advisers with public websites = 6,286 aggregate annual hours to post amendments of the relationship summary.

[798] Based on data from the SIFMA Office Salaries Report, we expect that the posting requirements of rule 204–5 will most likely be performed by a general clerk at an estimated cost of $60 per hour. 0.91 hours per adviser × $60 = $54.30 per adviser. $54.30 per adviser × 91.1% × 7,625 existing advisers = $377,188 in annual monetized costs.

[799] 7,625 advisers amending the relationship summary × 4,461 retail clients per adviser × 50% delivering the amended relationship summary to communicate updated information × 0.02 hours per delivery × 1.81 amendments annually = 615,674 hours to deliver amended relationship summaries.

[800] 4,461 retail clients per adviser × 0.02 hours per delivery × 1.81 amendments annually = 161.5 hours per adviser.

[801] Based on data from the SIFMA Office Salaries Report, we expect that delivery requirements of rule 204–5 will most likely be performed by a general clerk at an estimated cost of $60 per hour. 615,674 hours × $60 = $36,940,426. We estimate that advisers will not incur any incremental postage costs to deliver the relationship summary for communicating updated information by delivering the relationship summary, because we assume that advisers will make the delivery along with other documents already required to be delivered, such as an interim or annual update to Form ADV, or will deliver the relationship summary electronically.

[802] Based on data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, we expect that delivery requirements of rule 204–5 will most likely be performed by a general clerk at an estimated cost of $60 per hour. 161.5 hours per adviser × $60 per hour = $9,689 per adviser.

[803] This average is based on advisers' responses to Item 5 of Part 1A of Form ADV as of December 31, 2017.

[804] The number of retail clients reported by RIAs changed by 6.7% between December 2015 and 2016, and by 2.3% between December 2016 and 2017. (6.7% + 2.3%)/2 = 4.5% average annual rate of change over the past two years.

[805] This is the same as the estimate for the burden to deliver the brochure required by Form ADV Part 2. *See* Brochure Adopting Release, *supra* note 157.

[806] 4,461 clients per adviser with retail clients × 4.5% = 201 new clients per adviser. 201 new clients per adviser × .02 hours per delivery = 4.0 hours per adviser for delivery of a relationship summary to new or prospective new clients.

[807] 4.0 hours per adviser for delivery obligation to new or prospective clients × 7,625 advisers = 30,614 hours.

[808] Based on data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, we expect that delivery requirements of rule 204–5 will most likely be performed by a general clerk at an estimated cost of $60 per hour. 7,625 hours × $60 = $1,836,817. We estimate that advisers will not incur any incremental postage costs to deliver the relationship summary to new or prospective clients because we assume that advisers will make the delivery along with other documentation normally provided in such circumstances, such as Form ADV Part 2. $1,835,371/7,625 investment advisers = $241 per adviser.

[809] 1,230 annual hours for posting initial relationship summaries to adviser websites + 240,953 annual hours for initial delivery to existing clients + 72,286 hours for delivery to existing clients based on material changes to accounts or

126.8 hours per respondent,[810] for a total annual aggregate monetized cost of $58,022,611,[811] or $7,610[812] per adviser. We request comment on the estimated hourly and cost burdens for the new collection of information under proposed rule 204–5.

D. Form CRS and Rule 17a–14 Under the Exchange Act

New proposed rule 17a–14 under the Exchange Act [17 CFR 240.17a–14] and Form CRS [17 CFR 249.640] would require a broker-dealer that offer services to retail investors to prepare, file with the Commission, post to the broker-dealer's website (if it has one), and deliver to retail investors a relationship summary, as discussed in greater detail in Section II above. Broker-dealers would file the relationship summary with EDGAR and deliver the relationship summary to both existing customers and new or prospective new customers who are retail investors. New proposed rule 17a–14 under the Exchange Act [17 CFR 240.17a–14] and Form CRS [17 CFR 249.640] contain a collection of information requirement. We will use the information to manage our regulatory and examination programs. Clients can use the information required in Form CRS to determine whether to hire or retain a broker-dealer, as well as what types of accounts and services are appropriate for their needs. The collection of information is necessary to provide broker-dealer customers, prospective customers, and the Commission with information about the broker-dealer and its business, conflicts of interest and personnel. This collection of information would be found at 17 CFR 249.640 and would be mandatory. Responses would not be kept confidential.

1. Respondents: Broker-Dealers

The respondents to this information collection would be the broker-dealers registered with the Commission that would be required to deliver a relationship summary in accordance with proposed new rule 17a–14 under the Exchange Act [17 CFR 240.17a–14]. As of December 31, 2017, there were 2,857 broker-dealers registered with the Commission that reported sales to retail customer investors,[813] and therefore likely would be required to prepare and deliver the relationship summary.[814] We also note that these include 366 broker-dealers that are dually registered as investment advisers.[815] To a great extent, the burden for dual registrants to prepare and deliver the relationship summary and post it to a website is already accounted for in the estimated burdens for investment advisers under the proposed amendments to Form ADV and proposed new rule 204–5, discussed in Sections V.A and V.C above. However, dually registered broker-dealers will incur burdens related to their business as an investment adviser that standalone broker-dealers will not incur, such as the requirement to file the relationship summary with IAPD (in addition to EDGAR as a broker-dealer), and to deliver to both investment advisory clients and brokerage customers, to the extent those groups of retail investors do not overlap. Therefore, although treating dually registered broker-dealers in this way may be over-inclusive, we base our burden estimates for proposed rule 17a–14 and Form CRS on 2,857 broker-dealers with relationship summary obligations, including those dually registered as broker-dealers.[816]

2. Initial and Annual Burdens

a. Initial Preparation, Filing, and Posting of Relationship Summary

Unlike investment advisers, broker-dealers currently are not required to disclose in one place all of the information required by the relationship summary or to file a narrative disclosure document with the Commission. We estimate, therefore, that the initial first year burden for preparing and filing the relationship summary would be 15.0 hours per registered broker-dealer. The narrative descriptions required in the relationship summary should be narrowly tailored and brief, and the relationship summary must be limited to four pages (or equivalent limit if in electronic format). The relationship summary would be standardized across broker-dealers given the mandated set and sequence of topic areas, and moreover, a considerable amount of language within each topic area also would be prescribed, thereby limiting the amount of time required to prepare the disclosure. Therefore, we believe that the time needed to prepare the relationship summary should not vary significantly based on the size of the broker-dealer. However, unlike investment advisers, which already prepare Form ADV Part 2 brochures and have information readily available to prepare the relationship summary, broker-dealers would be required for the first time to prepare disclosure that contains all the information proposed to be required by the relationship summary. In addition, investment advisers already file their brochures on IARD, while broker-dealers may incur new burdens to file their relationship summaries on EDGAR. Therefore, we believe that each broker-dealer respondent would incur 15 hours on a one-time basis, instead of five hours for investment advisers, for the initial preparation and filing of the relationship summary. However, we believe that the amount of time needed to post the relationship summary on the broker-dealer's website, if it has one, would not vary significantly from the time needed by investment advisers because the time required to prepare and post disclosure that is standardized in length and content should not vary significantly across firms. As with investment advisers, we estimate that each broker-dealer would incur 0.5 hours to prepare the relationship summary for posting to its website, if it has one, such as to ensure proper electronic formatting, and to perform the actual posting.[817]

Given these assumptions, we estimate the total one-time initial hourly burden for broker-dealers to prepare the relationship summary and file it with the Commission would be 42,855

scope of relationship + 6,286 annual hours to post amended relationship summary to website + 615,674 hours for delivery to existing clients to communicate updated information in amended relationship summaries + 30,614 hours for delivery to new or prospective clients = 967,044 annual total hours for investment advisers to post and deliver the relationship summary under proposed rule 204–5.

[810] 967,044 hours (initial and other deliveries)/ 7,625 advisers = 126.8 hours per adviser.

[811] $73,809 for posting initial relationship summaries to adviser websites + $14,457,209 for initial delivery to existing clients + $4,337,162 for delivery to existing clients based on material changes to accounts or scope of relationship + $377,188 to post amended relationship summary to website + $36,940,426 for delivery to existing clients to communicate updated information in amended relationship summaries + $1,836,817 for delivery to new or prospective clients = $58,022,611 in total annual aggregate monetized cost for investment advisers to post and deliver the relationship summary under proposed rule 204–5.

[812] $58,022,611/7,625 advisers = $7,610 per adviser.

[813] *See supra* note 461 and accompanying text. Retail sales activity is identified from Form BR (*see supra note* 280, which categorizes retail activity broadly (by marking the ''sales'' box) or narrowly (by marking the ''retail'' or ''institutional'' boxes as types of sales activity). We use the broad definition of sales as we preliminarily believe that many firms will just mark ''sales'' if they have both retail and institutional activity. However, we note that this may capture some broker-dealers that do not have retail activity, although we are unable to estimate that frequency.

[814] For purposes of Form CRS, a ''retail investor'' would be defined as: a prospective or existing client or customer who is a natural person (an individual) and would include a trust or other similar entity that represents natural persons, even if another person is a trustee or managing agent of the trust.

[815] *See supra* note 457 and accompanying text.

[816] *See supra* note 457 and accompanying text.

[817] *See supra* note 780.

hours,[818] for a monetized value of $11,292,293.[819] We estimate that the initial burden of posting the relationship summary to their websites, if they have one, would be 1,428 hours,[820] for a monetized value of $85,710.[821] To arrive at an annual burden for preparing, filing, and posting the relationship summary, as for advisers, the initial burden would be amortized over a three-year period. Therefore, the total annual aggregate hour burden for registered broker-dealers to prepare, file, and post a relationship summary to their website, if they have one, would be 14,761 hours, or 5.17 hours per broker-dealer,[822] for an annual monetized cost of $3,792,668, or $1,328 per broker-dealer.[823]

b. Estimated External Costs for Initial Preparation of Relationship Summary

Under proposed new rule 17a–14, broker-dealers would be required to prepare and file a relationship summary, as well as post it to their website if they have one. We do not anticipate external costs in the form of website set-up, maintenance, or licensing fees because broker-dealers would not be required to establish a website for the sole purpose of posting their relationship summary if they do not already have a website. We do anticipate that some broker-dealers may incur a one-time initial cost for outside legal and consulting fees in connection with the initial preparation of the relationship summary. Although broker-dealers subject to the relationship summary requirement may vary widely in terms of the size, complexity and nature of their businesses, the amount of disclosure required would not vary substantially among broker-dealers. Accordingly, the amount of time, and thus cost, required for outside legal and compliance review is unlikely to vary substantially among those broker-dealers who elect to obtain outside assistance.[824] The relationship summary is short, standardized, and contains largely prescribed language. Because the information required in the relationship summary pertains largely to the broker-dealer's own business practices, the information is likely more readily available to the broker-dealer than to an external legal or compliance consultant. As a result, we anticipate that only a quarter of broker-dealers will seek the help of outside legal services and half will seek the help of compliance consulting services in connection with the initial preparation of the relationship summary. We estimate that the initial per broker-dealer cost for legal services related to the preparation of the relationship summary would be $1,416.[825] We estimate that the initial per broker-dealer cost for compliance consulting services related to the preparation of the relationship summary would be $2,109.[826] Accordingly, we estimate that 715 broker-dealers will use outside legal services, for a total initial aggregate cost burden of $1,011,378,[827] and 1,429 broker-dealers will use outside compliance consulting services, for a total initial aggregate cost burden of $3,012,707,[828] resulting in a total initial aggregate cost burden among all respondents of $4,024,085, or $1,409 per broker-dealer, for outside legal and compliance consulting fees related to preparation of the relationship summary.[829] Annually, this represents $1,341,362, or $470 per broker-dealer, when amortized over a three-year period.[830]

We do not expect ongoing external legal or compliance consulting costs for the relationship summary. Although broker-dealers would be required to amend the relationship summary within 30 days whenever any information becomes materially inaccurate, given the standardized nature and prescribed language of the relationship summary, we expect that amendments would be factual and require relatively minimal wording changes. We believe that broker-dealers would be more knowledgeable about these facts than outside legal or compliance consultants and would be able to make these revisions in-house. Therefore, we do not expect that broker-dealers will need to incur ongoing external costs for the preparation and review of relationship summary amendments.

c. Amendments to the Relationship Summary and Filing and Posting of Amendments

As with our estimates above for investment advisers, we do not expect broker-dealers to amend their relationship summaries frequently. Based on staff experience, we believe that many broker-dealers, as a matter of best practices, would update their relationship summary at a minimum once a year, after conducting an annual supervisory review, for example.[831] We also estimate that on average, each broker-dealer preparing a relationship summary may amend the disclosure once more during the year, due to emerging issues. Therefore, we assume that broker-dealers would update their relationship summary, on average, twice a year, and as with investment advisers, we estimate that broker-dealers would require 0.5 hours to amend and file the updated relationship summary, and 0.5 hours to post it to their website. Thus, we estimate that broker-dealers would incur a total annual aggregate hourly

[818] 15.0 hours × 2,857 broker-dealers with retail accounts = 42,855 total hours.

[819] 42,855 total aggregate initial hour burden for preparing and filing a relationship summary. We expect that performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the SIFMA Management and Professional Earnings Report suggest that costs for these positions are $229 and $298 per hour, respectively. (21,427.5 hours × $229 + (21,427.5 hours × $298 = $11,292,293).

[820] 0.5 hours × 2,857 broker-dealers = 1,248 hours to prepare and post relationship summary to the website.

[821] Based on data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, we expect that performance of this function will most likely be performed by a general clerk at an estimated cost of $60 per hour. 1,429 hours × $60 = $85,710 total aggregate monetized cost.

[822] 42,855 hours/3 years = 14,761 total aggregate annual hour burden to prepare and file relationship summary. 14,761 hours/2,857 broker-dealers with retail accounts = 5.17 hours annually per broker-dealer.

[823] ($11,292,293 total initial aggregate monetized cost for preparation and filing + $85,710 for posting to the website)/3 = $3,792,668 total annual monetized cost for preparation, filing and posting the relationship summary. $3,792,668/2,857 broker-dealers subject to relationship summary obligations = $1,328 per broker-dealer.

[824] We estimate that an external service provider would spend 3 hours helping a broker-dealer prepare an initial relationship summary.

[825] External legal fees are in addition to the projected hour per broker-dealer burden discussed above. $472 per hour for legal services × 3 hours per broker-dealer = $1,416. The hourly cost estimate of $472 is adjusted for inflation and based on our consultation with broker-dealers and law firms who regularly assist them in compliance matters.

[826] External compliance consulting fees are in addition to the projected hour per broker-dealer burden discussed above. Data from the SIFMA Management and Professional Earnings Report suggest that outside management consulting services cost approximately $703 per hour. $703 per hour for outside consulting services × 3 hours per adviser = $2,109.

[827] 25% × 2,857 SEC registered broker-dealers = 715 broker-dealers. $1,416 for legal services × 715 broker-dealers = $1,011,378.

[828] 50% × 2,857 SEC registered broker-dealers = 1,429 broker-dealers. $2,109 for compliance consulting services × 1,429 broker-dealers = $3,012,707.

[829] $1,011,378 + $3,012,707 = $4,024,085. $4,024,085/2,857 broker-dealers = $1,409 per broker-dealer.

[830] $4,024,085 initial aggregate hours/3 years = $1,341,362 annually. $1,409 initial hours per broker-dealer/3 years = $469.50.

[831] FINRA rules set an annual supervisory review as a minimum threshold for broker-dealers, for example in FINRA Rules 3110 (requiring an annual review of the businesses in which the broker-dealer engages), 3120 (requiring an annual report detailing a broker-dealer's system of supervisory controls, including compliance efforts in the areas of antifraud and sales practices); and 3130 (requiring each broker-dealer's CEO or equivalent officer to certify annually to the reasonable design of the policies and procedures for compliance with relevant regulatory requirements).

burden of 5,714 hours per year, to prepare and file, and post to their websites an estimated total of 5,714 amendments per year.[832]

d. Delivery of the Relationship Summary

Proposed rule 17a–14 under the Exchange Act would require a broker-dealer to deliver the relationship summary, with respect to a retail investor that is a new or prospective customer, before or at the time the retail investor first engages the broker-dealer's services. Broker-dealers also would make a one-time, initial delivery of the relationship summary to all existing customers within a specified time period after the effective date of the proposal. Also with respect to existing customers, broker-dealers would deliver the relationship summary before or at the time (i) a new account is opened that is different from the retail investor's existing account(s); or (ii) changes are made to the retail investor's account(s) existing account(s) that would materially change the nature and scope of the broker-dealer's relationship with the retail investor, as further discussed in II.C.2 above.

i. One-Time Initial Delivery to Existing Customers

We estimate the burden for broker-dealers to make a one-time initial delivery of the relationship summary to existing customers based on an estimate of the number of accounts held by these broker-dealers. Based on FOCUS data, we estimate that the 2,857 broker-dealers that report retail activity have approximately 128 million customer accounts, and that approximately 79%, or 101.248 million, of those accounts belong to retail customers.[833] We estimate that, under the proposed rule, broker-dealers would send their relationship summary along with other required disclosures, such as periodic account statements, in order to comply with initial delivery requirement for the relationship summary. As with investment advisers, we estimate that a broker-dealer will require no more than 0.02 hours to send the relationship summary to each customer, or an aggregate initial burden of 2,024,960 hours, or approximately 709 hours per broker-dealer for the first year after the rule is in effect.[834] We would therefore expect the aggregate monetized cost for broker-dealers to make a one-time initial delivery of relationship summaries to existing customers to be $121,497,600.[835] Amortized over three years, the total annual hourly burden is estimated to be 674,987 hours, or approximately 236.3 hours per broker-dealer,[836] with annual monetized costs of $40,499,200 and $14,175, respectively.[837] We do not expect that broker-dealers will incur external costs for the initial delivery of the relationship summary to existing clients because we assume that they will make such deliveries along with another required delivery, such as periodic account statements.

ii. Delivery for New Account Types or Material Changes in the Nature or Scope of the Brokerage Relationship

Broker-dealers would be required to deliver the relationship summary to existing customers before or at the time (i) a new account is opened that is different from the retail investor's existing account(s); or (ii) changes are made to the retail investor's existing account(s) that would materially change the nature and scope of the adviser's relationship with the retail investor, as further discussed in Section II.C.2. With respect to delivery of the relationship summary in the event of material changes in the nature or scope of the brokerage relationship, as with investment advisers, we estimate that this would take place among 10% of a broker-dealer's retail investors annually. We would therefore estimate broker-dealers to incur a total annual aggregate burden of 202,496 hours, or 71 hours per broker-dealer,[838] at an annual aggregate monetized cost of $12,149,760, or approximately $4,253 per broker-dealer.[839] We do not expect broker-dealers to incur external costs related to deliveries of the relationship summary due to new account type openings, or material changes to the nature or scope of the relationship, because we assume that broker-dealers will deliver the relationship summary along with new account agreements and other documentation normally required in such circumstances, or with periodic account statements.

iii. Communicating Changes to Amended Relationship Summaries, Including by Delivery

As discussed above, broker-dealers must communicate any changes in an updated relationship summary to retail investors who are existing customers of the firm within 30 days after the updates are required to be made and without charge. The communication can be made by delivering the relationship summary or by communicating the information in another way to the retail investor. Consistent with our discussion on broker-dealers' amendments to the relationship summary we are assuming that the 2,857 broker-dealers with relationship summaries will amend them twice each year. We also assume that 50% will choose to deliver the relationship summary to communicate the update information. As with investment advisers, we estimate that broker-dealers would require 0.02 hours to make a delivery to each customer. Therefore, the estimated burden for those broker-dealers choosing to deliver an amended relationship summary to meet this communication requirement

[832] 2,857 broker-dealers amending relationship summaries × 2 amendments per year = 5,714 amendments per year. 5,714 amendments × (0.5 hours to amend and file + 0.5 hours to post to website) = 5,714 hours.

[833] *See supra* notes 428–437 and accompanying text. 2,857 broker-dealers (including dual registrants) report 128 million customer accounts. We are aware that, based on data from IARD, investment advisers reporting retail activity have approximately 79.1% retail clients and 21.9% non-retail clients. While acknowledging the differences between the investment adviser and broker-dealer models, we apply the 79.1% in estimating the proportion of broker-dealer accounts that belong to retail customers. Therefore, 79.1% × 128 million accounts = 101.248 million accounts. This number likely overstates the number of deliveries to be made due to the double-counting of deliveries to be made by dual registrants to a certain extent, and the fact that one customer may own more than one account.

[834] (0.02 hours per customer account × 101.248 million customer accounts) = 2,024,960 hours. We note that the burden for preparing updated relationship summaries is already incorporated into the burden estimate for Form CRS discussed above. 2,024,960 hours/2,857 broker-dealers = approximately 709 hours per broker-dealer.

[835] Based on data from SIFMA's Office Salaries Report, we expect that initial delivery requirement to existing clients of rule 17a–14 will most likely be performed by a general clerk at an estimated cost of $60 per hour. 2,024,960 hours × $60 = $121,497,600. We estimate that broker-dealers will not incur any incremental postage costs because we assume that they will make such deliveries with another mailing the broker-dealer was already delivering to clients, such as periodic account statements.

[836] 2,024,960 initial aggregate hours/3 = 674,987 total annual aggregate hours. 709 initial hours per broker-dealer/3 = 236.3 total annual hours per broker-dealer.

[837] $121,497,600 initial aggregate monetized cost/3 = $40,499,200 annual aggregate monetized cost. $40,499,200/2,857 broker-dealers = $14,175 annual monetized cost per broker-dealer.

[838] 10% of 101.248 million customers × .02 hours = 202,496 hours. 202,496 hours/2,857 broker-dealers = 71 hours per broker-dealer.

[839] Based on data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, we expect that delivery requirements of rule 17a–14 will most likely be performed by a general clerk at an estimated cost of $60 per hour. 202,496 hours × $60 = $12,149,760. $12,149,760/2,857 broker-dealers = $4,253 per broker-dealer. We estimate that broker-dealers will not incur any incremental postage costs in these deliveries of the relationship summary to existing customers, because we assume that broker-dealers will make such deliveries with another mailing the broker-dealer was already delivering to clients, such as periodic account statements, or new account agreements and other similar documentation.

would be approximately 2,024,960 hours, or 709 hours per broker-dealer,[840] translating into a monetized cost of $121,497,600 in aggregate, or $42,526 per broker-dealer.[841] Similar to the other delivery requirements relating to proposed rule 17a–14, we do not expect broker-dealers to incur external costs in delivering amended relationship summaries because we assume that they will make this delivery with other documents required to be delivered, such as periodic account statements.

e. Delivery to New Clients or Prospective New Customers

To estimate the delivery burden for broker-dealers' new or prospective new customers, as discussed above, we estimate that the 2,857 standalone broker-dealers with retail activity have approximately 101.248 million retail customer accounts.[842] Based on FOCUS data over the past five years, we estimate that broker-dealers grow their customer base and enter into new agreements with, on average, 8% more new retail investors each year.[843] We estimate the hour burden for initial delivery of a relationship summary would be the same by paper or electronic format, at 0.02 hours for each relationship summary, as we have estimated above. Therefore, the aggregate annual hour burden for initial delivery of the relationship summary by broker-dealers to new or prospective new customers would be 161,917 hours, or 56.7 hours per broker-dealer.[844] at a monetized cost of $9,715,001 at an aggregate level, or $3,400 per broker-dealer.[845]

f. Total New Initial and Annual Burdens

As discussed above, we estimate the total annual collection of information burden for proposed new rule 17a–14 in connection with obligations relating to the relationship summary, including (i) initial preparation, filing, and posting to a website; (ii) amendments to the relationship summary for material updates and related filing and website posting burdens; (iii) one-time initial delivery to existing customers; (iv) delivery to existing customers who are opening new accounts or materially changing the nature or scope of their relationship with the broker-dealer; (v) delivery of amended relationship summaries; and (vi) delivery to new and prospective customers. Given these proposed requirements, we estimate the total annual aggregate hourly burden to be approximately 3,084,835 hours per year, or 1,080 hours on a per broker-dealer basis.[846] This translates into an aggregate annual monetized cost of $188,578,462, or $66,066 on a broker-dealer basis per year.[847] In addition, we estimate that broker-dealers would incur external legal and compliance costs in the initial preparation of the relationship summary of approximately $4,024,085 in aggregate, or $1,409 per broker-dealer, translating into $1,341,362 annually, or $470 per broker-dealer, when amortized over a three year period.

E. Recordkeeping Obligations Under Rule 17a–3 of the Exchange Act[848]

The proposed requirement to make a record indicating the date that a relationship summary was provided to each customer and to each prospective customer who subsequently becomes a customer would contain a collection of information that would be found at 17 CFR 240.17a–3(a)(24) and would be mandatory. The Commission staff would use this collection of information in its examination and oversight program, and the information generally is kept confidential.[849] The likely respondents to this collection of information requirement are the approximately 2,857 broker-dealers currently registered with the Commission that offer services to retail investors, as defined above.[850]

Exchange Act section 17(a)(1) requires registered broker-dealers to make and keep for prescribed periods such records as the Commission deems ''necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of'' the Exchange Act.''[851] Exchange Act rules 17a–3 and 17a–4 specify minimum requirements with respect to the records that broker-dealers must make, and how long those records and other documents must be kept, respectively.

The amendments to rule 17a–3 that we are proposing today would require SEC-registered broker-dealers to make a record indicating the date that a relationship summary was provided to each customer and to each prospective customer who subsequently becomes a customer. Commission staff has estimated that the proposed amendments to rule 17a–3(a)(24) would result in an incremental burden increase of 0.1 hours annually for each of the estimated SEC-registered broker-dealers that would be required to prepare and preserve the initial relationship summary and any amendments.[852]

The incremental hour burden for broker-dealers to maintain the relationship summary would therefore

[840] 2 amendments per year × 101.248 million customer accounts × 50% delivering the amended relationship summary to communicate updated information × 0.02 hours per delivery = 2,024,960 hours to deliver amended relationship summaries. 2,024,960 hours/2,857 broker-dealers = 709 hours per broker-dealer.

[841] Based on data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, we expect that delivery requirements of rule 17a–14 will most likely be performed by a general clerk at an estimated cost of $60 per hour. 2,024,960 hours × $60 = $121,497,600. $121,467,600/2,857 broker-dealers = $42,526 per broker-dealer. We estimate that broker-dealers will not incur any incremental postage costs to deliver these relationship summaries, because we assume that advisers will make the delivery along with other documentation they normally would provide, such as account opening documents.

[842] *See supra* notes 429–439 and accompanying text.

[843] This represents the average annual rate of growth from 2012–2016 in the number of accounts for all broker-dealers reporting retail activity.

[844] 101.248 million customer accounts × 8% increase = 8,095,834 new customers. 8,095,834 new customers × 0.02 hours per delivery = 161,917 total annual aggregate hours. 161,917/2,857 broker-dealers = 56.7 hours per broker-dealer for delivery to new customers.

[845] Based on data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, we expect that these functions will most likely be performed by a general clerk at an estimated cost of $60 per hour. 161,917 hours × $60 = $9,715,001. $9,715,001/2,857 broker-dealers = $3,400 per broker-dealer for delivery to new customers. We estimate that broker-dealers will not incur any incremental postage costs to deliver the relationship summary to new or prospective clients because we assume that broker-dealers will make the delivery along with other documentation, such as periodic account statements.

[846] 14,761 hours per year for initial preparation, filing, and posting of relationship summary + 5,714 hours per year for amendments, filing, and posting of amendments + 674,987 hours for one-time initial delivery to existing customers + 202,496 hours for delivery to existing customers making material changes to their accounts + 2,024,960 hours for delivery of amendments + 161,917 hours for delivery to new customers = 3,084,835 total annual aggregate hours. 3,084,835 hours/2,857 broker-dealers = 1,080 hours per broker-dealer.

[847] $3,792,668 per year for initial preparation, filing, and posting of relationship summary + $924,240 per year for amendments, filing, and posting of amendments + $40,499,200 for one-time initial delivery to existing customers (amortized over three years) + $12,149,760 for delivery to existing customers making material changes to their accounts + $121,497,600 for delivery of amendments + $9,715,001 for delivery to new customers = $188,578,468 in total annual aggregate monetized cost. $188,578,468/2,857 broker-dealers = $66,066 per broker-dealer.

[848] In a concurrent release, we are proposing additional burden adjustments to rules 17a–3 and 17a–4 of the Exchange Act. *See* Regulation Best Interest Proposal, *supra* note 24.

[849] *See* section 24(b) of the Exchange Act (15 U.S.C. 78x–24(b)).

[850] *See supra* note 29 and accompanying text.

[851] *See* section 17(a) of the Exchange Act.

[852] We apply the same 0.2 hour estimate as with investment advisers, but divided equally between creating a record of the relationship summary and its deliveries and the maintenance of those records.

be 286 hours,[853] for a monetized cost of 17,481 in aggregate, or $6.00 per broker-dealer.[854]

F. Record Retention Obligations Under Rule 17a–4 of the Exchange Act

Exchange Act section 17(a)(1) requires registered broker-dealers to make and keep for prescribed periods such records as the Commission deems ''necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of'' the Exchange Act.'' [855] Exchange Act rule 17a–4 specifies minimum requirements with respect to how long records created under Exchange Act rule 17a–3 and other documents must be kept. We are proposing amendments to rule 17a–4 that would require broker-dealers to retain copies of each relationship summary, including amendments, and to preserve the record of dates that each relationship summary and each amendment thereto was delivered to any existing customer or to any new or prospective customer, pursuant to the proposed new requirements under amended rule 17a–3, discussed above. These records would be required to be maintained in an easily accessible place for at least six years after such record or relationship summary is created. This collection of information would be found at 17 CFR 240.17a–4 and would be mandatory. The Commission staff would use the collection of information in its examination and oversight program. Requiring maintenance of these disclosures as part of the broker-dealer's books and records would facilitate the Commission's ability to inspect for and enforce compliance with firms' obligations with respect to Form CRS. The information generally is kept confidential.[856]

The likely respondents to this collection of information requirement are the approximately 2,857 broker-dealers that report retail activity, as described above.

1. Changes in Burden Estimates and New Burden Estimates

The approved annual aggregate burden for rule 17a–4 is currently 1,042,416 hours, with a total annual aggregate monetized cost burden of approximately $67.8 million, based on an estimate of 4,104 broker-dealers and 150 broker-dealers maintaining an internal broker-dealer system.[857] The currently approved external cost estimate to respondents is $20,520,000.[858] We estimate that the proposed amendments would result in an increase in the collection of information burden estimate by 0.10 hours [859] for each of the estimated 2,857 currently registered broker-dealers that report retail sales activity and would have relationship summary obligations.[860] This would yield an annual estimated aggregate burden of 754,964 hours for all broker-dealers with relationship summary obligations to comply with rule 17a–4,[861] for a monetized cost of approximately $48.6 million.[862] In addition, the 984 broker-dealers [863] not subject to the proposed amendments would continue to be subject to an unchanged burden of 254 hours per broker-dealer, or 249,936 hours for these broker-dealers.[864] In addition, those maintaining an internal broker-dealer system would continue to be subject to an unchanged burden of 450 hours annually, under rule 17a–4. In summary, taking into account the estimated annual burden of broker-dealers that would be required to maintain records of the relationship summary, as well the estimated annual burden of broker-dealers that do not have relationship summary obligations and whose information collection burden is unchanged, the revised annual aggregate burden for all broker-dealer respondents to the recordkeeping requirements under rule 17a–4 is estimated to be 976,350 total annual aggregate hours,[865] for a monetized cost of approximately $65.4 million.[866]

2. Revised Annual Burden Estimates

As noted above, the approved annual aggregate burden for rule 17a–4 is currently 1,042,416 hours, with a total annual aggregate monetized cost burden of approximately $67.8 million, based on an estimate of 4,104 broker-dealers and 150 broker-dealers maintaining an internal broker-dealer system. The revised annual aggregate hourly burden for rule 17a–4 would be 976,350 [867] hours, represented by a monetized cost of approximately $65.4 million,[868] based on an estimate of 2,857 broker-dealers with the relationship summary obligation and 984 broker-dealers without, as noted above. This represents a decrease of 66,516 [869] annual aggregate hours in the hour burden and an annual decrease of approximately $2.37 million from the currently approved total aggregate monetized cost for rule 17a–4.[870] These changes are attributable to the proposed amendments to rule 17a–4 relating to the relationship summary as discussed in this proposing release and the decline in the number of registered broker-dealer respondents. The revised external cost to respondents is estimated at approximately $19.2 million, or a reduction of $1.3 million from the currently approved external cost burden of $20,520,000.[871]

G. Rule 151–3 Under the Exchange Act

Proposed new rule 151–3 would require broker-dealers and their associated natural persons to prominently disclose that it is, or in the case of a natural person that such person is associated with a broker-

[853] 2,857 broker-dealers × 0.1 hours annually = 286 annual hours for recordkeeping.

[854] As with our estimates relating to the proposed amendments to rule 204–2 under the Advisers Act (*see, e.g., supra* note 771 and accompanying text), we expect that performance of this function will most likely be allocated between compliance clerks and general clerks, with compliance clerks performing 17% of the function and general clerks performing 83% of the function. Data from the SIFMA Office Salaries Report suggest that costs for these position are $67 and $60, respectively. (17% × 286 hours × $67) + (83% × 286 hours × $60) = $17,481. $17,481/2,857 broker-dealers = $6.00 per broker-dealer.

[855] *See* section 17(a) of the Exchange Act.

[856] *See* section 24(b) of the Exchange Act (15 U.S.C. 78x–24(b)).

[857] (4,104 broker-dealers × 254 hours per broker-dealer) + (150 broker-dealers maintaining internal broker-dealer systems × 3 hours) = (1,042,416 hours + 450 hours) = 1,042,866 hours each year. The monetized cost was based on these functions being performed by a compliance clerk earning an average of $65 per hour, resulting in a total internal cost of compliance of (1,042,416 × $65) + (450 × $65) = $67,786. *See* 17a–4 Supporting Statement, *available at https://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201607-3235-007*.

[858] 4,104 broker-dealers × $5,000 annual recordkeeping cost per broker-dealer = $20,520,000. *See id.*

[859] We apply the same 0.2 hour estimate as with investment advisers, but divided equally between creating a record of the relationship summary and its deliveries and the maintenance of those records.

[860] *See supra* note 616.

[861] 2,857 broker-dealers required to prepare relationship summary × (254 hours + 0.1 hour) = 725,964 hours.

[862] Consistent with our prior paperwork reduction analyses for rule 17a–4, we expect that performance of this function will most likely be performed by compliance clerks. Data from the SIFMA Office Salaries Report suggest that costs for these positions are $67 per hour. 725,964 hours × $67 = $48,639,568.

[863] *See supra* note 618.

[864] 984 broker-dealers × 254 hours = 249,936 hours for broker-dealers not preparing a relationship summary.

[865] 725,964 + 249,936 + 450 = 976,350 total aggregate hours.

[866] Consistent with our prior paperwork reduction analyses for rule 17a–4, we expect that performance of this function will most likely be performed by compliance clerks. Data from the SIFMA Office Salaries Report suggest that costs for these positions are $67 per hour. 976,650 hours × $67 = $65,415,430.

[867] *See supra* note 865.

[868] *See supra* note 739.

[869] 1,042,866 hours − 976,350 hours = 66,516 hours.

[870] $67,786,290 − $65,415,430 = $2,370,860.

[871] 3,841 registered broker-dealers as of December 31, 2017 × $5,000 per broker-dealer in record maintenance costs = $19,205,000. $20,520,000 − $19,205,000 = $1,315,000.

dealer that is, registered with the Commission as a broker-dealer in print or electronic retail investor communications. For print communications, we propose to require that such registration status be displayed in a type size at least as large as and of a font style different from, but at least as prominent as, that used in the majority of the communication. In addition, such disclosure must be presented in the body of the communication and not in a footnote. For electronic communications, or in any publication by radio or television, we propose to require that such disclosure be presented in a manner reasonably calculated to draw retail investor attention to it.

Rule 151–3 contains a collection of information requirement. This collection of information would be found at [17 CFR 240.15l–3] and would be mandatory. The likely respondents to this information collection would be all broker-dealers and their associated natural persons that distribute print or electronic retail investor communications.

The Commission believes that the collection of information is necessary to provide retail investors and the Commission with information to better determine whether a communication is from a broker-dealer or investment adviser, and, for retail investors specifically, to allow them to better identify which type of firm is more appropriate for their specific investment needs. Additionally, by requiring an affirmative identification, retail investors would also be better informed whether a financial professional is an associated person of a broker-dealer rather than a supervised person of an investment adviser, allowing them to make a more informed choice as to which type of professional is appropriate for their financial goals.

1. Respondents: Broker-Dealers and Associated Natural Persons

Currently, there are 3,841 registered broker-dealers and 435,071 associated natural persons licensed with FINRA.[872] Of these registered broker-dealers, we estimate that approximately 74% or 2,857 distribute print or electronic retail investor communications [873] while 435,071 associated natural persons distribute print or electronic retail investor communications at standalone broker-dealers or dually registered firms.[874] Of these broker-dealers that distribute print or electronic retail investor communications, 1,388 are large broker-dealers and 1,469 are small broker-dealers.[875] Accordingly, the Commission estimates that 2,857 broker-dealers and 435,071 associated natural persons would be required to comply with proposed rule 15l–3. For the purposes of this analysis of the paperwork burden associated with the proposed rules, the Commission preliminarily estimates that there would be approximately 2,857 broker-dealer respondents and 435,071 associated natural person respondents. [876]

2. Initial and Annual Burdens

We estimate that the initial one time burden for complying with the disclosure requirements would be 72 hours per large broker-dealer [877] and 15 hours per small broker-dealer.[878] We note that we are staging the compliance date to ensure that firms can phase out certain older communications from circulation through the regular business lifecycle rather than having to retroactively change them.[879] As a result of this staged compliance, our burden estimates do not reflect the burdens that would have been imposed had these firms had to replace all outstanding communications.

Aside from certain anticipated outside legal costs, as discussed below, we preliminary estimate that to comply with our proposed rule with respect to print communications,[880] broker-dealers would need to review their communications, identify which would need to be amended, make the changes, and verify that all firm communications comply with the rule's requirements including its technical specifications such as the type size, font, and prominence. Therefore, for existing print communications for large broker-dealers, we preliminarily estimate that the total burden for broker-dealers would be 8 hours for compliance and business operations personnel to review, identify, and make changes across all print communications.[881] For

[872] The number of broker-dealers is as of Dec. 31, 2017. Such associated natural persons are registered as registered representatives with FINRA through Form U4 as of Dec. 31, 2017. We took the total 494,399 registered representatives across standalone broker-dealers, dually registered firms, and standalone investment advisers and isolated those registered representatives that act on behalf of standalone broker-dealers and dually registered firms (*i.e.* 88%). *See supra* Section IV.A.1.e, Economic Analysis: Registered Representatives of Broker-Dealers, Investment Advisers and Dually Registered Firms.

[873] *See* Section IV.A, *supra* note 460 and accompanying text. As noted above, as of December 2017, 3,841 broker-dealers filed Form BD. Retail sales by broker-dealers were obtained from Form BR.

[874] *See supra* Section IV.A.1.e, at Table 5. For the purposes of the Paperwork Reduction Act analysis applicable to proposed rules 15l–3 and 211h–1, we are defining a ''dually registered firm'' in the same manner as ''dual registrant'' is defined in the baseline of the Economic Analysis. *See supra* Section IV, note 453.

We assume for the purposes of this rule that all 435,071 registered representatives engage retail investors. This estimate is based on the following calculation: (494,399 total licensed registered representatives) × (12% (the percentage of pure investment adviser representatives)) = 59,328 representatives at standalone investment advisers. Then, to isolate the number of representatives at standalone broker-dealers and dually registered firms, subtract 59,328 from 494,399 = 435,071 retail-facing, licensed registered representatives at standalone broker-dealers or dually registered firms.

[875] For the purposes of this proposed rule, we define large broker-dealers as those with total assets greater than 1 million and small broker-dealers as those with less than 1 million in total assets. *See* Table 1, Panel B *supra* Section IV.A.1.a. We note that this distinction differs from the distinction used for proposed rule 211h-1 below because historically we have used the number of employees rather than total assets to distinguish small and large investment advisers. *See cf.* Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 3221 (Jun. 22, 2011), at n.727 (''Release 3221''). Additionally, we believe that because broker-dealer services encompass a small set of large broker-dealers and thousands of smaller broker-dealers competing for niche or regional segments of the market, the number of employees would not provide the best estimate for how firms would be impacted by our proposed rule based on the number of communications produced. Instead, we believe that total assets properly account for the varying sizes of these smaller broker-dealers and are a better indicator as to how many communications would be impacted in proportion to a firm's size. More specifically, we assume that the greater the total assets, the larger the firm and associated number of customer accounts which in turn would lead to a greater number of communications with retail investors.

[876] We note that we are not analyzing new broker-dealers or associated natural persons because there has been a downward trend in broker-dealer registration and the number of associated natural persons has not shown signs of a noticeable increase over the past few years. From 2016 through 2018 the number of broker-dealers registered with the Commission decreased by 160. (4064 − 3904) = 160. *See also* FINRA Statistics, *available at https://www.finra.org/newsroom/statistics#reps.*

[877] (8 hours for print communications per large broker-dealer + 64 hours for electronic communications per large broker-dealer).

[878] (5 hours for print communications per small broker-dealer + 10 hours for electronic communications per small broker-dealer).

[879] Similarly, we are not requiring firms to send new communications to replace all older print communications as this would be overly burdensome and costly for firms.

[880] Such communications could include business cards, letterheads, newspaper advertisements, and article reprints from an unaffiliated magazine or newspaper.

[881] This estimate is based upon staff experience and industry sources more generally. *See e.g.,* Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 2210, Exchange Act Release No. 34–75377 (Jul. 7, 2015), at Economic Impact Assessment (''FINRA 2015–22 Notice'') (stating with reference to adding BrokerCheck links to mid-size and smaller firm communications, which we believe is analogous to the manual changes made to print communications, that ''mid-size and small members typically have less complex websites, which they manage and maintain with nontechnical staff. These members would use personnel in non-technical roles to

smaller broker-dealers, we preliminarily estimate that the total burden for broker-dealers would be 5 hours for compliance and business operations personnel to review, identify, and make changes across all print communications.[882] We note that there is a difference between large broker-dealers and smaller broker-dealers. We assume that large broker-dealers will have to review, identify and change more print communications and in turn have their compliance staff verify more print communications as being compliant with our proposed rule as compared to small broker-dealers which will have fewer print communications.

With respect to electronic communications,[883] we preliminarily anticipate that it would take large broker-dealers approximately 64 hours[884] to review, identify and make the required updates coupled with verifying that such communications (present and future) would be compliant with the proposed rule. Our estimates take into account that larger firms likely have full-featured websites that generate other webpages based on complex system code and logic.[885] In order to make changes to comply with our proposed rule, we assume that business operations and information technology personnel would likely be required to update the underlying code and logic to automate the implementation of the required language to populate across all associated electronic media. Additionally, we assume that these teams would need to test to ensure that such changes were implemented correctly.

With respect to smaller broker-dealers, we preliminarily anticipate that it would take approximately 10 hours[886] to review, identify and make the required updates coupled with verifying that such communications (present and future) would be compliant with the proposed rule. Our estimate for smaller broker-dealers assumes that smaller broker-dealers have fewer electronic communications that would be subject to our proposed rule as compared to larger firms, resulting in a lower burden preliminary estimate.

We preliminarily estimate that the total initial burden for broker-dealers is 121,971 hours.[887] We preliminarily estimate a cost of approximately $33,179,514 for broker-dealers.[888] This would be an annual average burden of 43 hours per broker-dealer[889] (as monetized, is an average annual burden per broker-dealer of $11,613).[890]

We further preliminarily anticipate that associated natural persons would have an initial one-time burden of 0.5 hours for each associated natural person respondent to review, identify, and make changes to their individual communications, both print and electronic.[891] Based on staff experience,

accomplish the required updates to their websites . . . [I]t would take mid-size or small members approximately eight hours of non-technical staffs' time to make the required updates . . .'').

To compute the 8 hours internal initial burden we assume 2 hours by compliance personnel and 6 hours by business operations personnel of the broker-dealer.

[882] This estimate is based upon staff experience and industry sources more generally. *See e.g.,* FINRA 2015–22 Notice, *supra* note 881. To compute the 5 hours internal initial burden we assume 1 hour by compliance personnel and 4 hours by business operations personnel of the broker-dealer.

[883] We believe such communications could include websites, smart phone apps, social media, emails, and blogs.

[884] This estimate is based upon staff experience and industry sources more generally. *See e.g.,* FINRA 2015–22 Notice, *supra* note 881. (''These estimates are based on FINRA's assumption that large members typically have full-featured websites that dynamically generate webpages based on data and logic. The technology personnel at these members would be required to update the underlying information in order to automate the implementation of references and hyperlinks to BrokerCheck across all applicable webpages. FINRA estimates that on average it would take large members approximately 60 hours of technology staffs' time to make the required updates . . .''). To compute the 64 hours internal initial burden we assume 4 hours by compliance personnel and 60 hours by business operations and information technology personnel of the broker-dealer.

[885] This is based upon staff experience and industry sources more generally. *See e.g.,* FINRA 2015–22 Notice, *supra* note (discussing the burdens associated with the inclusion of a BrokerCheck reference and hyperlink across all firm communications for certain firms).

[886] This estimate is based upon staff experience and industry sources more generally. *See e.g.,* FINRA 2015–22 Notice, *supra* note 881 (stating with reference to adding BrokerCheck links to firm communications that ''mid-size and small members typically have less complex websites, which they manage and maintain with nontechnical staff. These members would use personnel in non-technical roles to accomplish the required updates to their websites . . . [I]t would take mid-size or small members approximately eight hours of non-technical staffs' time to make the required updates . . .'').

To compute the 10 hours internal initial burden, we assume 2 hours by compliance personnel and 8 hours by business operations and information technology personnel of the broker-dealer.

[887] (8 hours for print communications per large broker-dealer + 64 hours for electronic communications per large broker-dealers) = 72 hours per large broker-dealer. (72 hours × 1,388 large broker-dealers) = 99,936 total initial burden for large broker-dealers.

(5 hours for print communications per small broker-dealer + 10 hours for electronic communications per small broker-dealer) = 15 hours per small broker-dealer. (15 hours × 1,469 small broker-dealers) = 22,035 total initial burden for small broker-dealers.

(99,936 total initial burden large broker-dealers + 22,035 total initial burden small broker-dealers) = 121,971 total broker-dealer initial burden.

[888] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270. The average technology and business rate is ($268 business rate + $270 technology rate)/2 = $269 average rate.

This figure was calculated as follows: (6 compliance hours × $298 compliance rate) + (66 technology/business hours × $269 averaged technology/business rate) × 1,388 large broker-dealers = $27,124,296 total initial costs for large broker-dealers.

(3 compliance hours × $298 compliance rate) + (12 technology/business hours × $269 averaged technology/business rate) × 1,469 small broker-dealers = $6,055,218 total initial costs for small broker-dealers.

$27,124,296 total initial cost for large broker-dealers + $6,055,218 total initial cost for small broker-dealers = $33,179,514 total initial costs for all broker-dealers.

[889] (8 hours for print communications per large broker-dealer + 64 hours for electronic communications per large broker-dealers) = 72 hours per large broker-dealer. (72 hours × 1,388 large broker-dealers) = 99,936 total initial burden for large broker-dealers.

(5 hours for print communications per small broker-dealer + 10 hours for electronic communications per small broker-dealer) = 15 hours per small broker-dealer. (15 hours × 1,469 small broker-dealers) = 22,035 total initial burden for small broker-dealers.

99,936 total initial burden large broker-dealers + 22,035 total initial burden small broker-dealers = 121,971 total broker-dealer initial burden/2,857 total broker-dealers = 43 total initial burden per broker-dealer.

[890] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270. The average technology and business rate is ($268 business rate + $270 technology rate)/2 = $269 average rate.

This figure was calculated as follows: (6 compliance hours × $298 compliance rate) + (66 technology/business hours × $269 averaged technology/business rate) × 1,388 large broker-dealers = $27,124,296 total initial costs for large broker-dealers.

(3 compliance hours × $298 compliance rate) + (12 technology/business hours × $269 averaged technology/business rate) × 1,469 small broker-dealers = $6,055,218 total initial costs for small broker-dealers.

$27,124,296 total initial cost for large broker-dealers + $6,055,218 total initial cost for small broker-dealers = $33,179,514 total initial costs for all broker-dealers/2,857 total number of broker-dealers = $11,613 total initial cost per broker-dealer.

[891] This estimate is based upon staff experience. *See e.g.,* Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Release No. 2968 (Dec. 30, 2009) (''Release 2968'') (''We further estimate that the adviser will spend 10 minutes per client drafting and sending the notice.''); Enhanced Mutual Fund Disclosure Adopting Release*,* *supra* note 47 (''we estimate, as we did in the proposing release, that rule 498 will impose a ½ hour burden per portfolio annually associated with the compilation of the additional information required on a cover page or at the beginning of the Summary Prospectus. Rule 498 also imposes annual hour burdens associated with the posting of a fund's Summary Prospectus, statutory prospectus, SAI, and most recent report to shareholders on an Internet website. We estimate that the average hour burden for one portfolio to comply with the Internet website posting

Continued

we anticipate that many firms will make many communication changes for their associated natural persons, including their business cards and letterheads, leaving only certain responsibilities to the individual such as changes to their individual social media profile(s) and email signatures. Therefore, we preliminarily estimate that the total initial one-time burden for associated natural persons is 217,536 hours.[892] We preliminarily estimate a monetized cost of approximately $31,107,576.50 for associated natural persons.[893] This would be an annual average burden of 0.5 hours per associated natural person [894] (as monetized, is an average annual burden per associated natural person of $71.50).[895]

Aside from the internal initial burden, we anticipate that there will be certain associated outside costs as well. We believe that broker-dealers and their associated natural persons may engage outside counsel to assist them in understanding our proposed rule should it be adopted.[896] We assume that the amount of outsourced legal assistance would vary among various sizes of broker-dealers and their number of associated natural persons. As a result, we preliminarily estimate that large broker-dealers together with their associated natural persons may initially outsource approximately 8 hours of legal time in order to understand the implications of our proposed rule, including which communications are subject to the proposed rule and how best to comply with the technical specifications.[897] For small broker-dealers, we anticipate that such firms will outsource 4 hours of legal time.[898] Our preliminary estimates take into account that large firms have more communications affected by our proposed rule and more associated natural persons to supervise than smaller firms. We estimate initial outside legal costs associated with the proposed rule of $8,014,560 for broker-dealers [899] or $2,805 per broker-dealer.[900]

Additionally, we anticipate that firms will also have one-time outside cost associated with the cost of printing new communications including new business cards, envelopes, pitch books, and letterheads. As part of these costs, we anticipate that both large and small broker-dealers will have to work with printers to set the disclosure on, for example, business cards. We estimate initial costs to amend certain communications associated with the proposed rule of $617,848,307 for broker-dealers [901] (or $216,258 per broker-dealer).[902] We assume that because small broker-dealers have fewer associated natural persons there will be less communications that will require printing.

For the ongoing burden of new communications for broker-dealers, we preliminarily estimate that the burden for legal, compliance, business operations, and technology services for adding a registration status statement would be 0.5 hours annual hours per broker-dealer.[903] We anticipate that broker-dealers will need to add the registration disclosure to each new communication which they create, however we anticipate the burdens associated with this task to be minimal and therefore we do not believe there is a material difference between large and small broker-dealers.[904] We

requirements will be approximately one hour annually.'').

[892] (0.5 hours × 435,071 associated natural persons) = 217,536 total initial burden for associated natural persons.

[893] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per associated natural person.

(0.5 × $143 total cost per associated natural person × 435,071 associated natural persons) = $31,107,576.50 total initial cost for associated natural persons.

[894] (0.5 hours × 435,071 associated natural persons) = 217,536 total initial burden for associated natural persons.

(217,536 total initial burden/435,071 total associated natural persons) = 0.5 total initial burden per associated natural person.

[895] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per associated natural person.

(0.5 × $143 total cost per associated natural person × 435,071 associated natural persons) = $31,107,576.50 total initial cost for associated natural persons.

($31,107,576.50 total initial cost for associated natural persons/435,071 total number of associated natural persons) = $71.50 total initial cost per associated natural person.

[896] We are assuming that associated natural persons would not independently seek outside counsel and would instead rely on the advice received from outside counsel to the firm. Therefore, we are not including a separate estimate for associated natural persons.

[897] This estimate is based upon staff experience. *See e.g.* Disclosure of Order Handling Information Proposed Rule, Securities Exchange Act Release No. 34–78309 (July 13, 2016) (''Release 34–78309'') (estimating 4 hours for legal burden ''to assign each order routing strategy for institutional orders into passive, neutral, and aggressive categories and establish and document its specific methodologies for assigning order routing strategies as required by Rule 606(b)(3)(v)''); Regulation of NMS Stock Alternative Trading Systems Proposed Rule, Securities Exchange Act Release No. 34–76474 (Nov. 18, 2015) (''Release 34–76474'') (estimating 7 legal hours ''to put in writing its safeguards and procedures to protect subscribers' confidential trading information and the oversight procedures to ensure such safeguards and procedures are followed . . .'').

[898] This estimate is based upon staff experience. *See supra* note 897.

[899] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for legal services is $472/hour.

($472 × 8 legal hours = $3,776 × 1,388 large broker-dealers = $5,241,088) + ($472 × 4 legal hours = $1,888 × 1,469 small broker-dealers = $2,773,472).

($5,241,088 large broker-dealers + $2,773,472 small broker-dealers) = $8,014,560 total cost.

[900] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for legal services is $472/hour.

($472 × 8 legal hours = $3,776 × 1,388 large broker-dealers = $5,241,088) + ($472 × 4 legal hours = $1,888 × 1,469 small broker-dealers = $2,773,472).

$5,241,088 large broker-dealers + $2,773,472 small broker-dealers = $8,014,560 total cost/2,857 broker-dealers = $2,805 total cost per broker-dealer.

[901] Our estimates are based on staff experience and industry sources. In particular, staff factored in its cost estimate the costs associated with printing envelopes, pitch books, letterheads, and business cards. For large broker-dealers, the staff assumes a printing cost of $445,121. For small broker-dealers, the staff assumes a printing cost of $20,359.

($445,121 × 1,388 large broker-dealers = $617,827,948) + ($20,359 × 1,469 small broker-dealers = $29,907,371) = $617,848,307 total broker-dealer outside costs.

[902] ($445,121 × 1,388 large broker-dealers = $617,827,948) + ($20,359 × 1,469 small broker-dealers = $29,907,371) = $617,848,307 total broker-dealer outside costs/2,857 broker-dealers = $216,258 total cost per broker-dealer.

[903] This estimate is based upon staff experience. *See e.g.,* Release 2968*, supra* note 891; Enhanced Mutual Fund Disclosure Adopting Release, *supra* note 47.

In this estimate we are not calculating the print and technological associated burdens of updating communications which we analyzed earlier as we are assuming those burdens to be a one-time initial burden for a firm seeking compliance with the proposed rule.

[904] Our assumption of no material difference between large and small rests on the fact that all major systems changes would already have been implemented as part of the initial one-time burden. Therefore, any new electronic communications would have the disclosure statement required by our proposed rule built in at the outset which should take minimal time rather than having to retroactively insert it into the systems logic which is a more onerous task. We note that such communications will need to be reviewed by

preliminarily estimate that the total ongoing annual aggregate burden for broker-dealers is 1,429 hours.[905] We preliminarily estimate a total ongoing monetized cost of approximately $204,275.50 for broker-dealers.[906] This would be an annual average burden of 0.5 hours per broker-dealer [907] (as monetized, is an average annual burden per broker-dealer of $71.50).[908]

For the ongoing burden of new communications for associated natural persons of a broker-dealer, we preliminarily estimate that the burden for compliance, business operations, and technology services for adding a registration status statement would be 0.5 hours.[909] Therefore, we preliminarily estimate that the total ongoing annual aggregate burden for associated natural persons is 217,536 hours.[910] We preliminarily estimate a total ongoing monetized cost of approximately $31,107,576.50 for associated natural persons.[911] This would be an ongoing annual average burden of 0.5 hours per associated natural person [912] (as monetized, is an average ongoing annual burden per associated natural person of $71.50).[913]

H. Rule 211h–1 Under the Advisers Act

Proposed rule 211h–1 would require investment advisers registered under section 203 and their supervised persons to prominently disclose that it is, or in the case of supervised persons that such persons are supervised by an investment adviser that is, registered with the Commission as an investment adviser in print or electronic retail investor communications. For print communications, we propose to require that such registration status be displayed in a type size at least as large as and of a font style different from, but at least as prominent as, that used in the majority of the communication. In addition, such disclosure must be presented in the body of the communication and not in a footnote. For electronic communications, or in any publication by radio or television, we propose to require that such disclosure be presented in a manner reasonably calculated to draw retail investor attention to it. This collection of information would be found at [17 CFR 240.15l–3] and would be mandatory. The likely respondents to this information collection would be all investment advisers and their supervised persons that distribute print or electronic retail investor communications.

The Commission believes that the collection of information is necessary to provide retail investors and the Commission with information to better determine whether a communication is from a broker-dealer or investment adviser, and, for retail investors specifically, to allow them to better identify which type of firm is more appropriate for their specific investment needs. Additionally, by requiring an affirmative identification, retail investors would also be better informed whether a financial professional is a supervised person of an investment adviser rather than an associated person of a broker-dealer. For similar reasons, we believe that because retail investors interact with a firm primarily through financial professionals, it is important that financial professionals disclose the firm type with which they are associated.

1. Respondents: Investment Advisers and Supervised Persons

Currently, there are 12,721 registered investment advisers and approximately 942,215 supervised persons.[914] Of these, 7,625 investment advisers distribute print or electronic retail investor

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compliance staff for compliance with applicable securities laws and associated self-regulatory agency rules, including FINRA Rule 2210. We anticipate that compliance with proposed rule 151–3's requirements will be reviewed as part of this larger compliance check.

[905] (0.5 hours × 2,857 broker-dealers) = 1,429 total ongoing burden for broker-dealers.

[906] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per broker-dealer.

(0.5 hours × $143 total cost per broker-dealer × 2,857 broker-dealers) = $204,275.50 total ongoing cost for broker-dealers.

[907] (0.5 hours × 2,857 broker-dealers) = 1,429 total ongoing burden for broker-dealers.

(1,429 total ongoing burden for broker-dealers/2,857 total broker-dealers) = 0.5 total initial burden per broker-dealer.

[908] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per broker-dealer.

(0.5 hours × $143 total cost per broker-dealer × 2,857 broker-dealers) = $204,275.50 total ongoing cost for broker-dealers/2,857 total number of broker-dealers = $71.50 total ongoing cost per broker-dealer.

[909] This estimate is based upon staff experience. *See e.g.,* Release 2968, *supra* note 891; Enhanced Mutual Fund Disclosure Adopting Release, *supra* note 47.

In this estimate we are not calculating the print and technological associated burdens of updating communications which we analyzed earlier as we are assuming those burdens to be a one-time initial burden for an associated natural person of a broker-dealer seeking compliance with the proposed rule.

[910] (0.5 hours × 435,071 associated natural persons) = 217,536 total ongoing burden for associated natural persons.

[911] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

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($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per associated natural person.

(0.5 hours × $143 total cost per associated natural person × 435,071 associated natural person) = $31,107,576.50 total ongoing cost for associated natural persons.

[912] (0.5 hours × 435,071 associated natural persons) = 217,536 total ongoing annual burden for associated natural persons.

(217,536 total ongoing burden/435,071 total associated natural persons) = 0.5 total ongoing annual burden per associated natural person.

[913] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per associated natural person.

(0.5 hours × $143 total cost per associated natural person × 435,071 associated natural person) = $31,107,576.50 total ongoing cost for associated natural persons/435,071 total number of associated natural persons) = $71.50 total ongoing annual cost per associated natural person.

[914] The investment adviser and supervised person numbers are as of December 31, 2017. *See supra* Section IV.A.1.b, at Table 3, Panel A. We note that our estimate of supervised persons is based on those supervised persons identified in the baseline in the Economic Analysis. *See* Section IV.A.1.e, at Table 6.

communications while 245,408 supervised persons distribute print or electronic retail investor communications at standalone investment advisers or dually registered firms.[915] Additionally, of these investment advisers 2,738 are large advisers and 4,887 are small advisers.[916] Accordingly, the Commission estimates that 7,625 investment advisers and 245,408 supervised persons would be required to comply with proposed rule 211h-1. There are also 477 new SEC registered investment advisers per year on average and 3,000 new supervised persons per year.[917]

2. Initial and Annual Burdens

We estimate that the initial one-time burden for complying with the disclosure requirements would be 72 hours per large investment adviser[918] and 15 hours per small investment adviser.[919] We note that we are staging the compliance date to ensure that firms can phase out certain older communications from circulation through the regular business lifecycle rather than having to retroactively change them.[920] As a result of this staged compliance, our burden estimates do not reflect the burdens that would have been imposed had these firms had to replace all outstanding communications.

Aside from certain anticipated outside legal costs, as discussed below, we preliminary estimate that to comply with our proposed rule with respect to print communications,[921] investment advisers would need to review their communications, identify which would need to be amended, make the changes, and verify that all firm communications comply with the rule's requirements including its technical specifications such as the type size, font, and prominence. Our preliminary estimates differ for large and small investment advisers. We drew these distinctions because we assume that the larger an adviser is the more communications it would need to review, identify and change and in turn have its compliance staff verify that such communications are compliant with our proposed rule.

For existing print communications for large investment advisers we preliminarily estimate that the total burden for investment advisers would be 8 hours for compliance and business operations personnel to review, identify, and make changes across all print communications.[922] For small investment advisers, we preliminarily estimate that the total burden for investment advisers would be 5 hours for compliance and business operations personnel to review, identify, and make changes across all print communications.[923]

With respect to electronic communications[924] we preliminarily anticipate that it would take large investment advisers approximately 64 hours[925] to review, identify and make the required updates coupled with verifying that such communications (present and future) would be compliant with the proposed rule. Our estimates take into account that larger firms likely have full-featured websites that generate other webpages based on complex system code and logic.[926] In order to make changes to comply with our proposed rule, we assume that business operations and information technology personnel would likely be required to update the underlying code and logic to automate the implementation of the required language to populate across all associated electronic media. Additionally, we assume that these teams would need to test to ensure that such changes were implemented correctly.

With respect to small investment advisers, we preliminarily anticipate that it would take approximately 10 hours[927] to review, identify and make the required updates coupled with verifying that such communications (present and future) would be compliant with the proposed rule. Our estimate for small investment advisers assumes that small investment advisers have fewer electronic communications that would be subject to our proposed rule as compared to larger firms, resulting in a lower burden preliminary estimate.

We preliminarily estimate that the total initial burden for investment advisers is 270,441 hours.[928] We

[915] We estimate the number of supervised persons who distribute print or electronic retail investor communications using several data points. First, we analyzed those supervised persons who only hold a series 65 at a dual registrant or an investment adviser firm, totaling 27,879. Next we analyzed those supervised persons at dual registrants or investment advisers holding a combination of either a series 6 and 65 or a series 7 and 65, totaling 15,381 and 172,304 respectively. Finally, we analyzed those supervised persons at dual registrants or investment advisers holding a series 6, 7, and 65, totaling 29,944. (27,879 + 15,281 + 172,304 + 29,944) = 245,408 total supervised persons who engage retail investors through print or electronic communications. We note that our estimate does not reflect supervised persons who hold various designations (*e.g.* Chartered Financial Analyst) in lieu of the licenses we used to identify supervised persons of investment advisers who distribute print or electronic retail investor communications. Finally, our estimate does not employ rounding as compared to Table 6 in the Economic Analysis Baseline. *See* Table 6: Number of Employees at Retail Facing Firms who are Registered Representatives, Investment Adviser Representatives, or Both, Section I.V.A.1.e. These numbers are as of December 31, 2017.

[916] For purposes of this estimate, we categorize small advisers as advisers with 10 or fewer employees and large advisers as those with 10 or more employees. *See cf.* Release 3221, *supra* note 875, at n.727.

[917] The number of new investment advisers is calculated by looking at the number of new advisers in 2016 and 2017 and then isolating the number each year that services retail investors. (455 for 2016 + 499 for 2017)/2) = 477.

The number of new supervised persons is calculated by looking at the difference in the number of supervised persons in 2017 as compared to 2016 at firms which service retail investors.

[918] (8 hours for print communications per broker-dealer + 64 hours for electronic communications per broker-dealer).

[919] (5 hours for print communications per broker-dealer + 10 hours for electronic communications per broker-dealer).

[920] Similarly, we are not requiring firms to send new communications to replace all older print communications as this would be overly burdensome and costly for firms.

[921] Such communications could include business cards, letterheads, newspaper advertisements, and article reprints from an unaffiliated magazines or newspaper.

[922] This estimate is based upon staff experience and industry sources more generally. *See e.g.,* FINRA 2015–22 Notice, *supra* note 881.

To compute the 8 hours internal initial burden we assume 2 hours by compliance personnel and 6 hours by business operations personnel of the broker-dealer.

[923] This estimate is based upon staff experience and industry materials more generally. *See e.g.,* FINRA 2015–22 Notice, *supra* note 881. To compute the 5 hours internal initial burden we assume 1 hour by compliance personnel and 4 hours by business operations personnel of the investment adviser.

[924] We believe such communications could include websites, smart phone apps, social media, emails, and blogs.

[925] This estimate is based upon staff experience and industry materials more generally. *See e.g.,* FINRA 2015–22 Notice, *supra* note 881. To compute the 64 hours internal initial burden we assume 4 hours by compliance personnel and 60 hours by business operations and information technology personnel of the investment adviser.

[926] This is based upon staff experience and industry materials more generally. *See e.g.,* FINRA 2015–22 Notice, *supra* note 881 (discussing the burdens associated with the inclusion of a BrokerCheck reference and hyperlink across all firm communications for certain firms).

[927] This estimate is based upon staff experience and industry materials more generally. *See e.g.,* FINRA 2015–22 Notice, *supra* note 881.

To compute the 10 hours internal initial burden, we assume 2 hours by compliance personnel and 8 hours by business operations and information technology personnel of the investment adviser.

[928] (8 hours for print communications per large investment adviser + 64 hours for electronic communications per large investment adviser) = 72 hours per large investment adviser.

(72 hours × 2,738 large investment advisers) = 197,136 total initial burden for large investment advisers.

(5 hours for print communications per small investment adviser + 10 hours for electronic communications per small investment adviser) = 15 hours per small investment adviser. (15 hours × 4887 small investment advisers) = 73,305 total initial burden for small investment advisers.

(197,136 total burden large investment advisers + 73,305 total burden small investment advisers) = 270,441 hours.

preliminarily estimate a cost of approximately $73,650,210 for investment advisers.[929] This would be an annual average burden of 35 hours per investment adviser[930] (as monetized, an annual average cost of $9,659 per investment adviser).[931]

We further preliminarily anticipate that supervised persons would have an initial burden of 0.5 hours for each supervised person respondent to review, identify, and make changes to their individual communications, both print and electronic.[932] Based on staff experience, we anticipate that many firms will make many communication changes for their supervised persons, including their business cards and letterheads, leaving only certain responsibilities to the individual such as changes to their individual social media profile(s) and email signatures. Therefore, we preliminarily estimate that the total initial one-time burden for supervised persons is 122,704 hours.[933] We preliminarily estimate a monetized cost of approximately $17,546,672 for supervised persons.[934] This would be an annual average burden of 0.5 hours per supervised person[935] (as monetized, is an annual average cost of $71.50 per supervised person).[936]

Aside from the internal initial burden, we anticipate that there would be certain associated outside costs as well. We believe that investment advisers and their supervised persons may engage outside counsel to assist them in understanding our proposed rule should it be adopted.[937] We assume that the amount of outsourced legal assistance would vary among various sizes of investment advisers and their number of supervised persons. As a result, we preliminarily estimate that large investment advisers together with their supervised persons may initially outsource approximately 8 hours of legal time in order to understand the implications of our proposed rule and how best to comply with the technical specifications.[938] For small investment advisers, we anticipate that such firms will outsource 4 hours of legal time.[939] The hour differences in our preliminary estimates take into account that larger firms have more communications affected by our proposed rule and more supervised persons to supervise than small firms. We estimate initial outside legal costs associated with the proposed rule of $19,565,344 for investment advisers[940] (or $2,566 on average per investment adviser.)[941]

Additionally, we anticipate that firms will also have one-time outside costs associated with the cost of printing new communications including new business cards, envelopes, pitch books, and letterheads. As part of these costs, we anticipate that both large and small investment advisers will have to work with printers to set the disclosure on, for example, business cards. We

[929] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services in the securities industry is $298, for business services is $268, and for technology services is $270. The average technology and business rate is ($270 technology rate + $268 business rate)/2 = $269 average rate.

This figure was calculated as follows: (6 compliance hours × $298 compliance rate) + (66 technology/business hours × $269 averaged technology/business rate) × 2,738 large investment advisers = $53,505,996 total initial costs for large investment advisers.

(3 compliance hours × $298 compliance rate) + (12 technology/business hours × $269 averaged technology/business rate) × 4,887 small investment advisers = $20,144,214 total initial costs for small investment advisers.

($53,505,996 total initial costs for large investment advisers + $20,144,214 total initial costs for small investment advisers) = $73,650,210 total initial costs for investment advisers.

[930] (8 hours for print communications per large investment adviser + 64 hours for electronic communications per large investment adviser) = 72 hours per large investment adviser.

(72 hours × 2,738 large investment advisers) = 197,136 total initial burden for large investment advisers.

(5 hours for print communications per small investment advisers + 10 hours for electronic communications per small investment adviser) = 15 hours per small investment adviser. (15 hours × 4887 small investment advisers) = 73,305 total initial burden for small investment advisers.

197,136 total burden large investment advisers + 73,305 total burden small investment advisers = 270,441 hours/7,625 total investment advisers = 35 hours average initial burden per investment adviser.

[931] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270. The average technology and business rate is ($268 business rate + $270 technology rate)/2 = $269 average rate.

This figure was calculated as follows: (6 compliance hours × $298 compliance rate) + (66 technology/business hours × $269 averaged technology/business rate) × 2,738 large investment advisers = $53,505,996 total initial costs for large investment advisers.

(3 compliance hours × $298 compliance rate) + (12 technology/business hours × $269 averaged technology/business rate) × 4,887 small investment advisers = $20,144,214 total initial costs for small investment advisers.

$53,505,996 total initial cost large investment advisers + $20,144,214 total initial costs small investment advisers = $73,650,210 total initial cost investment advisers/7,625 total number of investment advisers = $9,659 average initial cost per investment adviser.

[932] This estimate is based upon staff experience. *See e.g.,* Release 2968, *supra* note 891; Enhanced Mutual Fund Disclosure Adopting Release, *supra* note 47.

[933] (0.5 hours × 245,408 supervised persons) = 122,704 total initial burden for supervised persons.

[934] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per supervised person.

(0.5 hours × $143 total cost per supervised person × 245,408 supervised persons) = $17,546,672 total initial cost for supervised persons.

[935] (0.5 hours × 245,408 supervised persons) = 122,704 total initial burden for supervised persons.

(122,704 total initial burden for supervised persons/245,408 total supervised persons) = 0.5 hours average initial burden per investment adviser.

[936] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per supervised person.

(0.5 hours × $143 total cost per supervised person × 245,408 supervised persons) = $17,546,672 total initial cost for supervised persons/245,408 total number of supervised persons) = $71.50 average initial cost per supervised person.

[937] We are assuming that supervised persons would not independently seek outside counsel and would instead rely on the advice received from outside counsel to the firm. Therefore, we are not including a separate estimate for supervised persons.

[938] This estimate is based upon staff experience. *See e.g.,* Release 34–78309, *supra* note 897; Release 34–76474, *supra* note 897.

[939] This estimate is based upon staff experience. *See supra* note 938.

[940] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for legal services is $472/hour.

($472 × 8 legal hours) = $3,776 × 2,738 large investment advisers = $10,338,688.

($472 × 4 legal hours) = $1,888 × 4,887 small investment advisers = $9,226,656.

($10,338,688 total large investment advisers costs + $9,226,656 total small investment advisers costs) = $19,565,344.

[941] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for legal services is $472/hour.

($472 × 8 legal hours) = $3,776 × 2,738 large investment advisers = $10,338,688.

($472 × 4 legal hours) = $1,888 × 4,887 small investment advisers = $9,226,656.

$10,338,688 total large investment advisers costs + $9,226,656 total small investment advisers costs = $19,565,344/7625 total investment advisers = $2,566 total cost per investment adviser.

estimate initial costs to amend certain communications associated with the proposed rule of $346,787,187 for investment advisers[942] (or $45,480 per investment adviser.)[943] We assume that because small investment advisers have fewer supervised persons there will be less communications that will require printing.

For the ongoing burden of new communications for investment advisers, we preliminarily estimate that the burden for compliance, business operations, and technology services for adding a registration status statement would be 0.5 hours annual hours per investment adviser.[944] We anticipate that investment advisers will need to add the registration disclosure to each new communication which they create, however we anticipate the burdens associated with this task to be minimal and therefore we do not believe there is a material difference between large and small investment advisers.[945] We preliminarily estimate that the total ongoing annual aggregate burden for investment advisers is 3,812.50 hours.[946] We preliminarily estimate a total ongoing monetized cost of approximately $545,187.50 for investment advisers.[947] This would be an annual average burden of 0.5 hours per investment advisers[948] (as monetized, is an annual average cost of $71.50 per investment adviser).[949]

For the ongoing burden of new communications for supervised persons of an investment adviser, we preliminarily estimate that the burden for compliance, business operations, and technology services for adding a registration status statement would be 0.5 hours.[950] Therefore, we preliminarily estimate that the total ongoing annual aggregate burden for supervised persons is 122,704 hours.[951] We preliminarily estimate a total ongoing monetized cost of approximately $17,546,672 for supervised persons.[952] This would be an annual average burden of 0.5 hours per supervised person[953] (as monetized, is an annual average cost of $71.50 per supervised person).[954]

Additionally, we believe that any new investment advisers and their supervised persons would likely only incur the same ongoing annual burden estimate rather than the initial burden because they would incorporate the proposed registration status in all communications at their inception and not have to conduct a review and identification of outstanding communications nor make changes to their already existing communications. We do anticipate that such persons would also incur similar outside legal

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942 Our estimates are based on staff experience and industry materials. In particular, staff factored in its cost estimate the costs associated with printing envelopes, pitch books, letter heads, and business cards. For large investment advisers, we assume printing costs of $65,973. For small investment advisers, we assume printing costs of $33,999.

($65,973 × 2,738 large investment advisers = $180,634,074) + ($33,999 × 4,887 small investment advisers = $166,153,113) = $346,787,187 total investment adviser outside costs.

943 ($65,973 × 2,738 large investment advisers = $180,634,074) + ($33,999 × 4,887 small investment advisers = $166,153,113) = $346,787,187 total investment adviser outside costs/7,625 investment advisers = $45,480 total cost per investment adviser.

944 This estimate is based upon staff experience. *See e.g.,* Release 2968*, supra* note 891; Enhanced Mutual Fund Disclosure Adopting Release, *supra* note 47.

In this estimate we are not calculating the print and technological associated burdens of updating communications which we analyzed earlier as we are assuming those burdens to be a one-time initial burden for a firm seeking compliance with the proposed rule.

945 Our assumption of no material difference between large and small investment advisers rests on the fact that all major systems changes would already have been implemented as part of the initial burden. Therefore, any new electronic communications would have the disclosure statement required by our proposed rule built in at the outset which should take minimal time rather than having to retroactively insert it into the systems logic which is a more onerous task. We note that such communications would likely be reviewed by compliance staff for compliance with applicable securities laws including rule 206(4)–1 of the Advisers Act. We anticipate that compliance with proposed rule 211h–1's requirements would be reviewed as part of this larger compliance check.

946 (0.5 hours × 7,625 investment advisers) = 3,812.50 total ongoing burden for investment advisers.

947 Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per investment adviser.

(0.5 hours × $143 total cost per investment adviser × 7,625 investment advisers) = $545,187.50 total ongoing cost for investment advisers.

948 (0.5 hours × 7,625 investment advisers) = 3,812.50 total ongoing burden for investment advisers.

(3,812.5/7,625 total investment advisers) = 0.5 hours average initial burden per investment adviser.

949 Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per investment adviser.

(0.5 hours × $143 total cost per investment adviser × 7,625 investment advisers) = $545,187.50 total ongoing cost for investment advisers/7,625 total number of investment advisers = $71.50 average annual ongoing cost per investment adviser.

950 This estimate is based upon staff experience. *See e.g.,* Release 2968*, supra* note 891; Enhanced Mutual Fund Disclosure Adopting Release, *supra* note 47.

In this estimate we are not calculating the print and technological associated burdens of updating communications which we analyzed earlier as we are assuming those burdens to be a one-time initial burden for a supervised person of an investment adviser seeking compliance with the proposed rule.

951 (0.5 hours × 245,408 supervised persons) = 122,704 total ongoing burden for supervised persons.

952 Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per supervised person.

(0.5 hours × $143 total cost per supervised person × 245,408 supervised persons) = $17,546,672 total ongoing cost for supervised persons.

953 (0.5 hours × 245,408 supervised persons) = 122,704 total ongoing annual burden for supervised persons.

(122,704 total initial burden for supervised persons/245,408 total supervised persons) = 0.5 hours average ongoing annual burden per supervised person.

954 Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per supervised person.

(0.5 hours × $143 total cost per supervised person × 245,408 supervised persons) = $17,546,672 total ongoing cost for supervised persons/245,408 total number of supervised persons = $71.50 average ongoing annual cost per supervised person.

costs, depending on their size, as discussed above. We do not believe that such new investment advisers would incur outside printing costs as a result of our proposed rule because these new firms would have their print communications produced with the appropriate disclosure initially as part of other materials they seek to have printed. Therefore, we preliminarily estimate that the total burden for new investment advisers is 238.50 hours.[955] Additionally, we preliminarily estimate a cost of approximately $34,105.50 for new investment advisers.[956] This would be an initial average burden of 0.5 hours per new investment adviser [957] (as monetized, is an initial average cost of $71.50 per new investment adviser).[958] Additionally, we anticipate 1,500 hours [959] for new supervised persons of an investment adviser and costs of approximately $214,500 for new supervised persons [960] of an investment adviser resulting from these requirements. This would be an initial average burden of 0.5 hours per new supervised person [961] (as monetized, is an initial average cost of $71.50 per supervised person).[962]

I. Request for Comment

We request comment on our estimates for the new estimated burden hours and change in current burden hours, and their associated costs described above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) determine whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

The agency has submitted the proposed collections of information to OMB for approval. Persons wishing to submit comments on the collection of information requirements of the proposed amendments should direct them to the Office of Management and Budget, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549, with reference to File No. S7–08–18. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of the proposal, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–08–18, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington, DC 20549.

VI. Initial Regulatory Flexibility Analysis

The Commission has prepared the following Initial Regulatory Flexibility Analysis (''IRFA'') in accordance with section 3(a) of the Regulatory Flexibility Act (''RFA'').[963] It relates to: (i) Proposed new rule 204–5 under the Advisers Act and proposed amendment to, Form ADV (17 CFR 279.1), to add a new Part 3: Form CRS; (ii) proposed amendments to rule 203–1 under the Advisers Act; (iii) proposed amendments to rule 204–1 under the Advisers Act; (iv) proposed amendments to rule 204–2 under the Advisers Act; (v) proposed new rule 17a–14 under the Exchange Act and new Form CRS (17 CFR 249.640); (vi) proposed amendments to rules 17a–3 and 17a–4 under the Exchange Act; (vii) proposed new rules 15l–2 and 15l–3 under the Exchange Act; and (viii) proposed new rule 211h–1 under the Advisers Act.

[955] (0.5 hours × 477 new investment advisers) = 238.50 total burden for new investment advisers.

[956] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per investment adviser.

(0.5 hours × $143 total cost per investment adviser × 477 new investment advisers) = $34,105.50 total initial cost for new investment advisers.

[957] (0.5 hours × 477 new investment advisers) = 238.50 total initial burden for new investment advisers.

(238.50 total initial burden for new investment advisers/477 total new investment advisers) = 0.5 hours average initial burden per investment adviser.

[958] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per investment adviser.

(0.5 hours × $143 total cost per investment adviser × 477 new investment advisers) = $34,105.50 total cost for new investment advisers/477 total number of new investment advisers = $71.50 average initial cost per new investment adviser.

[959] (0.5 hours × 3,000 new supervised persons) = 1,500 total burden for new supervised persons.

[960] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per supervised person.

(0.5 hours × $143 total cost per supervised person × 3,000 new supervised persons) = $214,500 total cost for new supervised persons.

[961] (0.5 hours × 3,000 new supervised persons) = 1,500 total initial burden for new supervised persons.

(1,500 total initial burden for new supervised persons/3000 total new supervised persons) = 0.5 hours average initial burden per new supervised person.

[962] Based on the SIFMA Management and Professional Earnings Report, Commission staff preliminarily estimates that the average hourly rate for compliance services is $298, for business operation services is $268, and for information technology services is $270.

This figure was calculated as follows: 0.5 hours/3 firm staff categories (*i.e.,* compliance, business operations, and information technology) = 0.17 hours per staff category

($298 compliance/hour × 0.17) = $51 per 0.17 of an hour.

($268 business operations rate/hour × 0.17) = $46 per 0.17 of an hour.

($270 information technology rate/hour × 0.17) = $46 per 0.17 of an hour.

$51 + $46 + $46 = $143 total cost per supervised person.

(0.5 hours × $143 total cost per supervised person × 3,000 new supervised persons) = $214,500 total cost for new supervised persons/3,000 total number of new supervised persons = $71.50 average initial cost per new supervised person.

[963] 5 U.S.C. 603(a).

A. Reason for and Objectives of the Proposed Action

Individual investors rely on the services of broker-dealers and investment advisers when making and implementing investment decisions. Such ''retail investors'' can receive investment advice from a broker-dealer, an investment adviser, or both, or decide to make their own investment decisions. Broker-dealers, investment advisers and dually registered firms all provide important services for individuals who invest in the markets. Studies show that retail investors are confused about the differences among them.[964] These differences include the scope and nature of the services they provide, the fees and costs associated with those services, conflicts of interest, and the applicable legal standards and duties owed to investors. Studies also indicate that retail investors are confused about whether their firm and financial professional are broker-dealers or investment advisers, or both.[965] Based on these studies, it appears that certain names or titles used by broker-dealers, including ''financial advisor,'' contribute to this confusion and could mislead retail investors into believing that they are engaging with an investment adviser—and are receiving services commonly provided by an investment adviser and subject to an adviser's fiduciary duty, which applies to the retail investors' entire relationship—when they are not.[966]

We recognize the benefits of retail investors having access to diverse business models and of preserving investor choice among brokerage services, advisory services, or both. However, we believe that retail investors need clear information in order to understand the differences and key characteristics of each type of service. Providing this clarity is intended to assist investors in making an informed choice when choosing an investment firm and professional and type of account to help to ensure they receive services that meet their needs and expectations. We also believe it is important to mitigate the risk that certain names or titles could result in retail investors being misled, including believing that the financial professional is a fiduciary, leading to uninformed decisions regarding which firm or financial professional to engage, which may in turn result in investors being harmed.

The Commission considered ways to address investor confusion and preserve investor choice, including reviewing studies, comment letters, and committee recommendations.[967] We believe it is important to ensure that retail investors receive the information they need to clearly understand the services, standard of conduct, fees, conflicts, and disciplinary history of firms and financial professionals they are considering. We also believe it is important for retail investors to better understand the distinction between investment advisers and broker-dealers and to have access to the information necessary to make an informed decision about which firm type and financial professional they are engaging or seeking to engage and avoid potential harm.

1. Proposed Form CRS Relationship Summary

We are proposing new rules and rule amendments to require broker-dealers and investment advisers to deliver a Form CRS (or relationship summary) to retail investors that would include general information about each of these topics, including where to find additional information. We preliminarily believe that providing this information before or at the time a retail investor enters into an investment advisory agreement or first engages a brokerage firm's services, as well as at certain points during the relationship (*e.g.,* switching or adding account types), as further discussed above, is appropriate and in the public interest and will improve investor protection, and will deter potentially misleading sales practices by helping retail investors to make a more informed choice among the types of firms and services available to them.[968]

As discussed above in Section II.A, the relationship summary would be short, with a mix of tabular and narrative information, and contain sections covering: (i) Introduction; (ii) the principal relationships and services the firm offers to retail investors; (iii) the standard of conduct applicable to those services; (iv) the fees and costs that retail investors will pay; (v) comparisons of brokerage and investment advisory services (for standalone broker-dealers and investment advisers); (vi) conflicts of interest; (vii) where to find additional information, including whether the firm or its financial professionals currently have reportable legal or disciplinary events and who to contact about complaints; and (viii) key questions for retail investors to ask the firm's financial professional.

The proposed rules and rule amendments would require advisers and broker-dealers to deliver their relationship summaries to retail investors, to file them electronically with the Commission, and to post them electronically on their public websites (if they have a public website). If they do not have a public website, they would be required to include in their relationship summary a toll-free number that retail investors may call to request documents. We are also proposing to require firms to update their relationship summaries within 30 days whenever any information in the relationship summary becomes materially inaccurate. Firms would be required to file the updated version electronically with the Commission, and post them on their firms' websites (if they have a public website). Firms would be required to communicate any changes in an updated relationship summary to retail investors who are existing clients or customers of the firm within 30 days after the updates are required to be made and without charge. The communication could be made by delivering the relationship summary or by communicating the information in another way to the retail investor. The proposal would require a firm to maintain a copy of the relationship summary and each amendment or revision as part of its books and records and make them available to Commission staff upon request, as discussed in Section II.E above. All of these requirements are discussed in detail above in Sections I through IV. The burdens of these requirements on small advisers and broker-dealers are discussed below as well as above in our Economic Analysis and Paperwork Reduction Act Analysis, which discuss the burdens on all advisers and broker-dealers.[969]

As discussed in Section II above, the relationship summary would be in addition to, and not in lieu of, current disclosure and reporting requirements for broker-dealers and investment

[964] *See* Siegel & Gale Study, *supra* note 5; Rand Study, *supra* note 5; and CFA Survey, *supra* note 5.

[965] *See* Siegel & Gale Study, *supra* note 5; Rand Study, *supra* note 5; and 913 Study, *supra* note 3.

[966] *See supra* note 375.

[967] *See supra* notes 6–22 and accompanying text, referring to the Siegel & Gale Study, the RAND Study, the 913 Study, commenters responding to the 2013 Request for Data, the 917 Financial Literacy Study, comment letters of commenters providing input for these studies, the recommendation of the Commission's Investor Advisory Committee, and comment letters of commenters responding to Chairman Clayton's Request for Comment.

[968] *See supra* note 36 and accompanying text.

[969] *See, e.g.,* Sections IV.B.2.b and V.

advisers.[970] The relationship summary would alert retail investors to important information for them to consider when choosing a firm and a financial professional and prompt retail investors to ask informed questions. In addition, the content of the relationship summary would facilitate comparisons across firms. As discussed in Section II above, while the information required by the relationship summary is generally already provided in greater detail for investment advisers by Form ADV Part 2, the relationship summary would provide in one place information about the services, fees, conflicts, and disciplinary history for broker-dealers.[971]

2. Proposed Rules Relating to Restrictions on the Use of Certain Terms and Required Disclosure of Regulatory Status and a Financial Professional's Firm Association

We are also proposing a rule under the Exchange Act that would restrict broker-dealers and their associated natural persons, when communicating with a retail investor, from using as part of a name or title the term ''adviser'' or ''advisor'' unless any such (1) broker or dealer is an investment adviser registered under section 203 of the Advisers Act or with a state, or (2) natural person who is an associated person of a broker or dealer is a supervised person of an investment adviser registered under section 203 of the Advisers Act or with a state, and such person provides investment advice on behalf of such investment adviser. We are also proposing rules under the Exchange Act and Advisers Act that would require broker-dealers and investment advisers and their associated natural persons and supervised persons, respectively, to prominently disclose the firm's registration status with the Commission and the financial professional's association with such firm in print and electronic retail investor communications. As discussed above in Section III, the proposed restriction is designed to address the risk that retail investors could be misled by the term ''adviser'' or ''advisor'' and, as a result, make an uninformed decision regarding which firm or financial professional they are engaging or seeking to engage, resulting in investors being harmed. Additionally, as discussed above in Section III, we believe that requiring firms and their associated natural persons or supervised persons, respectively, to disclose whether a firm is a broker-dealer or investment adviser and requiring a financial professional to disclose his or her association with such firm would assist retail investors in determining which type of firm is more appropriate for their specific investment needs. Similarly, our proposed rules to require a firm to disclose whether it is a broker-dealer or an investment adviser in print or electronic communications to retail investors would help to facilitate investor understanding, even if investors currently may not understand the differences between investment advisers and broker-dealers. For similar reasons, we preliminarily believe that because retail investors interact with a firm primarily through financial professionals, it is important that financial professionals disclose the firm type with which they are associated.

B. Legal Basis

The Commission is proposing the following new rule and rule amendments under the authority set forth in section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 7sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 80a–37(a)], and sections 203(c)(1), 204, 206A, 206(4), 211(a) and 211(h), and of the Investment Advisers Act of 1940 [15 U.S.C. 80b–3(c)(1), 80b–4, 80b–6a, 80b–6(4), 80b–11(a) and 80b–11(h)], and section 913(f) of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the ''Dodd-Frank Act''): (i) Proposed new rule 204–5 under the Advisers Act ; (ii) amendments to rule 279.1, Form ADV, to create Form CRS for investment advisers; (iii) amendments to rule 203–1 under the Advisers Act; (iv) amendments to rule 204–1 under the Advisers Act; and (v) amendments to rule 204–2 under the Advisers Act. The Commission is proposing the following rule amendments under the authority set forth in section 913(f) of Title IX of the Dodd-Frank Act, sections 3, 10, 15, 23 and 36 of the Exchange Act [15 U.S.C. 78c, 78j, 78o, 78q, 78w and 78mm]: (i) Proposed new rule 17a–14 under the Exchange Act; (ii) proposed Form CRS (17 CFR 249.640) under the Exchange Act; and (iii) amendments to rule 17a–3 and 17a–4 under the Exchange Act. The Commission is also proposing the following new rules under the authority set forth in sections 15(l), 23(a), and 36 of the Securities Exchange Act of 1934 (78o(l), 78w(a), and 78mm), sections 211(h), 206A, 211(a) of the Investment Advisers Act of 1940, 15 U.S.C. 80b–1 et seq., (80b–11(h), 80b–6a, 80b–11(a), sections 913(f) and 913(g)(2) of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; (i) proposed new rule 15l–2 under the Exchange Act; (ii) proposed new rule 15l–3 under the Exchange Act; and (iii) proposed new rule 211h–1 under the Advisers Act.

C. Small Entities Subject to the Rule and Rule Amendments

In developing these proposals, we have considered their potential impact on small entities that would be subject to the proposed amendments. The proposed amendments would affect many, but not all, broker-dealers and investment advisers registered with the Commission, including some small entities.

1. Investment Advisers

Under Commission rules, for the purposes of the Advisers Act and the RFA, an investment adviser generally is a small entity if it: (1) Has assets under management having a total value of less than $25 million; (2) did not have total assets of $5 million or more on the last day of the most recent fiscal year; and (3) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[972] As discussed in Section V, above, the Commission estimates that based on IARD data as of December 31, 2017, approximately 7,625 investment advisers would be subject to the proposed new rule 204–5 under the Advisers Act, Form CRS (required by a new Part 3 of Form ADV), the proposed amendments to rules 203–1, 204–1, and rule 204–2 under the Advisers Act, and the proposed new rule 211h–1 under the Advisers Act.[973] Our proposed new

[970] *See, e.g., supra* note 33 and accompanying text.

[971] *See supra* text accompanying note 316. In addition, under Regulation Best Interest, broker-dealers would be required to disclose, in writing, the material facts relating to the scope and terms of the relationship with the retail customer and all material conflicts of interest that are associated with the recommendation. *See supra* note 296.

[972] Advisers Act rule 0–7(a).

[973] *See supra* Section V, at note 712 and accompanying text. Based on responses to Item 5.D. of Form ADV. These advisers indicated that they advise either high net worth individuals or individuals (other than high net worth individuals), which includes trusts, estates, and 401(k) plans and IRAs of individuals and their family members, but does not include businesses organized as sole proprietorships. The proposed definition of retail investor would include a trust or other entity similar entity that represents of natural persons,

Continued

rules and amendments would not affect most investment advisers that are small entities (''small advisers'') because they are generally registered with one or more state securities authorities and not with the Commission. Under section 203A of the Advisers Act, most small advisers are prohibited from registering with the Commission and are regulated by state regulators. Based on IARD data, we estimate that as of December 31, 2017, approximately 618 SEC-registered advisers are small entities under the RFA.[974] Of these, 179 provide advice to individual high net worth and individual non-high net worth clients, and would therefore be subject to the proposed Form CRS requirements and the related new and amended rules under the Advisers Act, and proposed new rule 211h–1 under the Advisers Act requiring disclosure of Commission registration status and a financial professional's association in certain communications with retail investors.[975]

2. Broker-Dealers

For purposes of a Commission rulemaking in connection with the RFA, a broker-dealer will be deemed a small entity if it: (1) Had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to rule 17a–5(d) under the Exchange Act,[976] or, if not required to file such statements, had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization.

As discussed in Sections IV and V, above, the Commission estimates that as of December 31, 2017, approximately 2,857 retail broker-dealers would be subject to the proposed Form CRS requirements and new rule 17a–14 under the Exchange Act, and proposed amendments to rule 17a–3 and 17a–4 under the Exchange Act, and proposed new rules 15l–2 and 15l–3 under the Exchange Act.[977] Further, based on FOCUS Report data, the Commission estimates that as of December 31, 2017, approximately 1,040 broker-dealers may be deemed small entities under the RFA.[978] Of these, approximately 802 have retail business, and would be subject to the proposed Form CRS requirements and related proposed new and amended rules, the proposed rule requiring disclosure of Commission registration status in certain communications with retail investors, and the proposed rule regarding the prohibition of certain terms in names or titles in certain communications with retail investors.[979]

D. Projected Reporting, Recordkeeping and Other Compliance Requirements

1. Initial Preparation of Form CRS Relationship Summary

Proposed Form CRS and the proposed rules and rule amendments would impose certain reporting and compliance requirements on certain advisers and broker-dealers, including those that are small entities, requiring them to create and update relationship summaries containing specified information regarding their advisory and brokerage businesses, as applicable. The proposed rules and rule amendments, including new recordkeeping requirements, are summarized in this RFA (Section VI.A., above). All of these proposed requirements are also discussed in detail, above, in Sections II.A–E., and these requirements and the burdens on advisers and broker-dealers, including those that are small entities, are discussed above in Sections IV and V (the Economic Analysis and Paperwork Reduction Act Analysis) and below.

The proposed amendments to Form ADV that would require each registered investment adviser that offers advisory services to retail investors to prepare, file and deliver Form CRS would impose additional costs on many registered advisers, including some small advisers. Our Economic Analysis, discussed in Section IV, above, discusses these costs and burdens for investment advisers, which include small advisers.[980] In addition, as discussed in our Paperwork Reduction Analysis, above, we anticipate that some advisers may incur a one-time initial cost for outside legal and consulting fees in connection with the initial preparation of the relationship summary.[981] Generally, all advisers, including small advisers that advise retail investors are currently required to prepare and distribute Part 2 of Form ADV (the firm brochure). Because advisers already provide disclosures about their services, fees, conflicts and disciplinary history in their firm brochures,[982] they would be able to use some of this information to respond to the disclosure requirements of the relationship summary. They would, however, have to draft completely new disclosure to comply with the proposed new format of Form CRS. As discussed above, approximately 179 small advisers currently registered with us would be subject to the proposed new Form ADV

even if another person is a trustee or managing agent of the trust. We are not able to determine, based on responses to Form ADV, exactly how many advisers provide investment advice to these types of trusts or other entities; however, we believe that these advisers most likely also advise individuals and are therefore included in our estimate.

974 Based on SEC-registered investment adviser responses to Items 5.F. and 12 of Form ADV.

975 Based on SEC-registered investment adviser responses to, Items 5.D.(a), 5.D.(b), 5.F. and 12 of Form ADV, which indicate that the adviser has clients that are high net worth individuals and/or individuals (other than high net worth individuals) and that the adviser is a small entity. Of these, 3 firms are dually registered as a broker-dealer and an investment adviser and may offer services to retail investors as both a broker-dealer and investment adviser (*e.g.,* ''dual registrants'' for purposes of the relationship summary). *See supra* note 25. Dual registrants would file Form CRS on both IARD and EDGAR describing their retail advisory and retail brokerage businesses. In this RFA, dual registrants are counted in both the total number of small entity investment advisers and broker-dealers that would be subject to Form CRS and the proposed related rules and rule amendments. We believe that counting these firms twice is appropriate because of their additional burdens of complying with the rules with respect to both their advisory and brokerage businesses and filing Form CRS with IARD and EDGAR.

976 *See* 17 CFR 240.0–10(c).

977 *See supra* note 461 and accompanying text. Retail sales activity is identified from Form BD, which categorizes retail activity broadly (by marking the ''sales'' box) or narrowly (by marking the ''retail'' or ''institutional'' boxes as types of sales activity). We use the broad definition of sales as we preliminarily believe that many firms will just mark ''sales'' if they have both retail and institutional activity. However, we note that this may capture some broker-dealers that do not have retail activity, although we are unable to estimate that frequency.

978 The Commission's estimate is obtained from Form BD filings. Although Form BD filings are updated on a more frequent basis than annually, FOCUS data, which also informs this baseline with respect to broker-dealers, is only sparsely updated throughout the year. Moreover, instead, broker-dealers tend to make their most complete updates in the fourth calendar quarter of each year. Therefore, in order to minimize discrepancies in the broker-dealer data between Form BD and FOCUS data, we have normalized all of the data to the most recently complete FOCUS data, which is for December 2017.

979 *Id.*

980 *See supra* notes 621–637 and accompanying text (discussing the direct costs of Form CRS and related requirements on broker-dealers and investment advisers, including costs associated with delivery, preparation, and firm-wide implementation of the relationship summary, as well as training and monitoring for compliance).

981 *See supra* notes 729–730 and accompanying text (stating, however, that we do not anticipate external costs to investment advisers in the form of website set-up, maintenance, or licensing fees because they would not be required to establish a website for the sole purpose of posting their relationship summary if they do not already have a website, and we also do not expect other ongoing external costs for the relationship summary).

982 Much of the disclosure in Part 2A addresses an investment adviser's conflicts of interest with its clients, and is disclosure that the adviser, as a fiduciary, must make to clients in some manner regardless of the form requirements. *See supra* note 314.

Part 3.[983] As discussed above in our Paperwork Reduction Act Analysis, we expect these 179 small advisers to spend, on average, an additional total of 23,152 annual hours, or approximately 129.34 hours per adviser,[984] which translates into an approximate monetized cost of $1,478,055, or $8,257 per adviser, attributable to the initial preparation, filing, posting, and delivery related to Form CRS.[985] We expect the incremental external legal and compliance cost for small entity investment advisers to be estimated at $525 per adviser, or $93,936 in aggregate for small advisers.[986]

Similarly, requiring each broker-dealer that offers brokerage services to retail investors to prepare, file and deliver Form CRS would impose additional costs on many broker-dealers, including some small broker-dealers. Our Economic Analysis, discussed in Section IV, above, discusses these costs and burdens for broker-dealers, which include small broker-dealers.[987] In addition, as discussed in our Paperwork Reduction Analysis, above, we anticipate that some broker-dealers may incur a one-time initial cost for outside legal and consulting fees in connection with the initial preparation of the relationship summary.[988] As discussed above,[989] unlike investment advisers, broker-dealers are not currently required to deliver to their retail investors written disclosures covering their services, fees, conflicts, and disciplinary history in one place such as the investment advisory firm brochure.[990] Under existing provisions of the Exchange Act and self-regulatory organization rules, however, a broker-dealer is required to disclose certain information to its customers.[991] To the extent that some of the new Form CRS disclosure burdens would apply to small broker-dealers, these broker-dealers are therefore already obligated to make certain of these disclosures to retail investors, although the disclosure is not currently required to be included in one comprehensive document such as Form ADV. As discussed above,[992] approximately 802 broker-dealers that are small entities would be subject to the proposed Form CRS requirements and proposed new and amended rules. As discussed above, we expect these 802 small broker-dealers to spend, on average, 1,080 hours per broker-dealer,[993] for a monetized value of $66,006 per broker-dealer,[994] or 865,956 aggregate annual hours to respond to the proposed new Form CRS requirements,[995] for an annual monetized burden of approximately $52,936,812. We expect the aggregate annual external third-party cost to small broker-dealers associated with this process would be $376,940.[996]

The costs associated with preparing the new relationship summaries will be limited for investment advisers and broker-dealers, including small entities, for several reasons. First, the disclosure document is concise (no more than four pages in length or equivalent limit if in electronic format), and much of the information is already provided by the broker-dealers and investment advisers as part of current disclosure practices. Second, the disclosure will be uniform across retail investors and would not be customized or personalized to potential investors. Third, the disclosure would involve a certain degree of standardization across firms. In particular, firms would be required to use the same headings, prescribed wording, and present the information under the headings in the same order. Additionally, firms would be prohibited from adding any items to those prescribed by the Commission and any information other than what the Instructions require or permit. These standardized elements allow for potential economies of scale for entities that may have subsidiaries that would also be required to produce the disclosure. The compliance costs could, however, be different across firms with relatively smaller or larger numbers of retail investors as customers or clients.[997]

Filing, Delivery, and Updating Requirements Related to Form CRS. As discussed above, a firm would be required to give a relationship summary to each retail investor, if the firm is an investment adviser, before or at the time the firm enters into an investment advisory agreement with the retail investor, or if the firm is a broker-dealer, before or at the time the retail investor first engages the services of the broker-dealer.[998] A firm would be required to deliver the relationship summary even if the firm's agreement with the retail investor is oral. A dual registrant would deliver the relationship summary at the earlier of entering into an investment advisory agreement with the retail investor or the retail investor engaging the firm's services. In order to ensure that existing retail investors receive the disclosures in the relationship summary, the Commission proposes that firms would deliver the relationship summary to retail investors who are existing clients and customers on an initial one-time basis within 30 days after the date the firm is first required to file its relationship summary with the Commission.[999] In addition, firms would be required to deliver the relationship summary to a retail investor who is an existing client or customer before or at the time a new account is opened or changes are made to the retail investor's account(s) that would materially change the nature and scope of the firm's relationship with the retail investor. This would include, for example, before or at the time the firm recommends that the retail investor transfers from an investment advisory account to a brokerage account or from a brokerage account to an investment advisory account, or moves assets from one type of account to another in a

[983] *See supra* note 975 and accompanying text.

[984] *See supra* Sections V.A.2, V.B, and V.C. 2.52 hours for preparing and filing of the relationship summary + 126.8 hours for posting to the website and delivery = 129.3 hours per adviser.

[985] *See supra* Sections V.A.2, V.B, and V.C. 129.3 hours × 179 small advisers = $23,152 in total annual aggregate hours for small advisers. $8,257 × 179 small advisers = $1,478,055 in total annual aggregate monetized cost for small advisers.

[986] *See supra* Section V.A.2.b.

[987] *See supra* notes 621–637 and accompanying text (discussing the direct costs of Form CRS and related requirements on broker-dealers and investment advisers, including costs associated with delivery, preparation, and firm-wide implementation of the relationship summary, as well as training and monitoring for compliance).

[988] *See supra* Section V.D.1. (stating, however, that we do not expect ongoing external legal or compliance consulting costs for the relationship summary).

[989] *See supra* Section IV, at note 629 and accompanying text.

[990] Broker-dealers are required under certain circumstances, such as when effecting certain types of transactions, to disclose certain conflicts of interest to their customers in writing, in some cases at or before the time of the completion of the transaction. *See* 913 Study, *supra* note 3, at nn.256–259 and accompanying text. *See supra* note 311 and accompanying text. Under Regulation Best Interest, broker-dealers would also be required to disclose the material facts relating to the scope and terms of the relationship. Regulation Best Interest Proposal, *supra* note 24.

[991] *See supra* Section II, at notes 309–312 and accompanying text. *See also* Regulation Best Interest Proposal, *supra* note 24.

[992] *See supra* note 979.

[993] *See supra* note 846.

[994] *See supra* note 847.

[995] *See supra* note 823 and accompanying text. 802 small broker-dealers × 1,080 hours per broker-dealer = 865,956 annual aggregate hours. 802 small broker-dealers × $66,006 in monetized cost per broker-dealer = 52,936,812 annual aggregate hours.

[996] *See supra* note 829 and accompanying text. 802 small broker-dealers × $470 in external legal and compliance costs on average per broker-dealer = $376,940.

[997] *See supra* note 628 and accompanying text (discussing the Commission's preliminary belief that compliance costs could be different across firms with relatively smaller or larger numbers of retail investors as customers or clients).

[998] *See supra* Section II.C for a discussion of the delivery requirements.

[999] *See supra* Section II.D for a discussion of the delivery requirements during the proposed transition period following the effectiveness of the proposed new rule.

transaction not in the normal, customary or already agreed course of dealing.

As discussed above, firms would be required to update the relationship summary within 30 days whenever any information in the relationship summary becomes materially inaccurate.[1000] Firms also would be required to post the latest version on its website (if it has one), and electronically file the relationship summary with the Commission. Firms would be required to communicate any changes in the updated relationship summary to retail investors who are existing clients or customers of the firm within 30 days after the updates are required to be made and without charge. The firm could communicate the information by delivering the amended relationship summary or by communicating the information in another way to the retail investor. We believe that this flexibility would minimize the burden of the communication requirement for all firms, including small advisers and broker-dealers. Firms also would also be required to deliver the relationship summary to a retail investor upon the retail investor's request.

In addition, firms would be permitted to deliver the relationship summary, as well as updates, electronically consistent with the Commission's prior guidance regarding electronic delivery. We believe that this would further minimize the burden of delivery for all firms, including small advisers and broker-dealers. To the extent that small advisers and broker-dealers are more likely to have fewer retail investors than larger advisers and broker-dealers, the proposed delivery requirements should impose lower variable costs on small advisers and broker-dealers than on larger firms. The additional hours per adviser and broker-dealer, the monetized cost per adviser and broker-dealer, and the incremental external legal and compliance cost for small entity investment advisers and broker-dealers, attributable to the initial preparation, filing, posting, delivery, and recordkeeping related to Form CRS, are estimated above and in the Paperwork Reduction Analysis.[1001]

Recordkeeping Requirements Related to Form CRS. The proposed amendments would impose new recordkeeping requirements on many investment advisers and broker-dealers, including some small advisers and broker-dealers. We are proposing amendments to Advisers Act rule 204–2 and Exchange Act rules 17a–3 and 17a–4, which set forth requirements for maintaining, making and preserving specified books and records, to require SEC-registered investment advisers and broker-dealers to retain copies of each relationship summary. Firms would also be required to maintain each amendment and revision to the relationship summary and a record of dates that each relationship summary and each amendment was delivered.

These proposed changes are designed to update the books and records rules in light of proposed Form CRS, and they mirror the current recordkeeping requirements for the Form ADV brochure and brochure supplement. The records for investment advisers would be required to be maintained in the same manner, and for the same period of time, as other books and records required to be maintained under rule 204–2(a) under the Advisers Act, and the records for broker-dealers would be required to maintained for six years after the record was created in accordance with rule 17a–4(e)(10) under the Exchange Act.[1002] As discussed in the Paperwork Reduction Act Analysis in Section IV above, the proposed amendments to rule 204–2 under the Advisers Act would increase the annual burden by approximately 0.2 hours per adviser, or 35.80 hours in aggregate for small advisers.[1003] We therefore expect the annual monetized aggregate cost to small advisers associated with our proposed amendments would be $2,148.[1004] Also as discussed in the Paperwork Reduction Act Analysis in Section IV above, the proposed amendments to rules 17a–3 and 17a–4 under the Exchange Act would increase the burden by approximately 0.2 annual hours per broker-dealer, or 160.4 annual hours in the aggregate.[1005] We expect the aggregate cost to small broker-dealers associated with our proposed amendments would be $9,624.[1006]

2. Rule 15l–2 Relating to Restrictions on the Use of Certain Terms in Names and Titles

As discussed above in Section III, we are proposing to restrict broker-dealers and associated natural persons of broker-dealers, when communicating with a retail investor, from using as part of a name or title the term ''adviser'' or ''advisor'' unless any such (1) broker or dealer is an investment adviser registered under section 203 of the Advisers Act or with a state, or (2) natural person who is an associated person of a broker or dealer is a supervised person of an investment adviser registered under section 203 of the Advisers Act or with a state, and such person provides investment advice on behalf of such investment adviser.

This would include such names or titles as, for example, financial advisor (or adviser), wealth advisor (or adviser), and trusted advisor (or adviser), and advisory (*e.g.,* ''Sample Firm Advisory'') when communicating with any retail investor.

The proposed rule would permit firms that are registered both as investment advisers and broker-dealers to use the term ''adviser'' or ''advisor'' in their name or title. The proposed rule would, however, only permit an associated natural person of a dually registered firm[1007] to use these terms where such person is also a supervised person of an investment adviser registered with the Commission or with a state and provides investment advice on behalf of such investment adviser. This would limit the ability of natural persons associated with a broker-dealer that do not typically provide investment advisory services to retail investors from continuing to use the term ''adviser'' or ''advisor'' by virtue of the fact that they are affiliated with a dually registered firm.

Proposed rule 15l–2 would impose certain compliance requirements on broker-dealers, including small broker-dealers, but would not impose reporting or recordkeeping requirements on broker-dealers. The compliance burdens on broker-dealers, including small broker-dealers, are described above in our Economic Analysis in Section IV. They would need to change their names or titles where their names or titles include ''adviser'' or ''advisor'' in violation of the proposed rule. As

[1000] *See supra* Section II.C.3 for a discussion of updating requirements.

[1001] *See supra* Sections V.A.–F.

[1002] *See supra* note 371 (referencing Advisers Act rule 204–2(e)(1) and Exchange Act rule 17a–4(e)(10), and stating that pursuant to Advisers Act rule 204–2(e)(1), investment advisers will be required to maintain the relationship summary for a period of five years, while Exchange Act rule 17a–4(e)(5) will require broker-dealers to maintain the relationship summary for a period of six years).

[1003] *See supra* note 765. 0.2 hours × 179 small entity retail investment advisers = 35.8.

[1004] *See supra* note 768.

[1005] 0.2 hours × 802 small broker-dealers = 160.4 hours.

[1006] *See supra* note 854 and accompanying text. $12 per broker-dealer × 802 small broker-dealers = $9,624.

[1007] For purposes of rules 15l–2, 15l–3 and 211h–1, we are defining a ''dually registered firm'' in the same manner as a ''dual registrant'' is defined in the baseline of the Economic Analysis. *See supra* Section IV, note 453. *See also supra* note 411. We use the more narrowly defined ''dual registrant'' for purposes of the relationship summary discussion only.

discussed in Section IV above, the Commission estimates that as of December 31, 2017, approximately 2,857 broker-dealers would be subject to the proposed rule 151–2 under the Exchange Act.[1008] As discussed in Section IV, above, approximately 103 broker-dealers that are not dually registered as investment advisers use the term ''adviser,'' ''advisor,'' or ''advisory'' as part of their current company name. To the extent these broker-dealers, some of which may be small entities, advise retail investors and would be subject to proposed rule 151–2, they would be subject to potentially substantial, one-time costs associated with the proposed rule. Broker-dealer firms subject to the restriction on the use of certain names or titles would be required to change current company names (if the company name contains ''adviser/advisor''), marketing materials, advertisements (*e.g.,* print ads or television commercials), website and social media appearance, among other items, resulting in direct compliance costs.

In addition, as discussed in Section IV, as a result of the proposed rule 151–2, broker-dealers would need to assess whether their associated natural persons use as part of a name or title the term ''adviser'' or ''advisor.'' As discussed in Section IV, financial professionals providing brokerage services use a large variety of names or titles to describe their business and the services that they offer, including ''financial advisor,'' ''financial consultant,'' ''banker,'' and ''broker.''[1009] To the extent their associated natural persons use the terms adviser'' or ''advisor'' when communicating with a retail investor, firms would need to assess whether to require their associated natural persons to change their names or title to comply with the proposed rule and modify their retail investor communications. We request comment on how many associated natural persons of broker-dealers, including small entity broker-dealers, are currently using the terms ''adviser'' or ''advisor'' in their names or titles, and how many of these associated natural persons are supervised persons of an investment adviser registered with the Commission or with a state and who provide investment advice on behalf of such investment adviser.

The proposed restriction on the use of the term ''adviser'' and ''advisor'' in a name or title does not apply to registered investment advisers, whether they are solely registered as investment advisers or whether they are dually registered as broker-dealers. Consequently, there would be no compliance costs for registered investment advisers associated with the restriction on certain terms in names or titles. However, as discussed in Sections III and IV, supervised persons of dually registered investment advisers who do not provide investment advice on behalf of such investment adviser would be restricted from using these terms when communicating with a retail investor, which could lead to costs for those financial professionals or their firms.

3. Rules 15l–3 and 211h–1 Relating to Disclosure of Commission Registration Status and Financial Professional Association

As discussed above, we are proposing rule 15l–3 under Exchange Act and rule 211h–1 under the Advisers Act that would require broker-dealers and investment advisers and their associated natural persons and supervised persons, respectively, to disclose the firm's registration status with the Commission and such financial professional's relationship with the firm in print or electronic retail investor communications. These rules would impose certain compliance requirements on many broker-dealers and investment advisers but would not impose separate reporting or recordkeeping requirements on investment advisers and broker-dealers. The compliance burdens on broker-dealers and investment advisers, including small broker-dealers and investment advisers, are described above in our Economic Analysis in Section IV and the Paperwork Reduction Act discussion in Section V. These include the requirement for investment advisers and broker-dealers that would be subject to the proposed rule to prominently disclose their registration status in print or electronic retail investor communications. In addition, associated natural persons would need to prominently disclose that they are associated persons of a broker-dealer registered with the Commission, and supervised persons would need to prominently disclose that they are supervised persons of an investment adviser registered with the Commission.

As discussed in Sections IV and V above, the Commission estimates that as of December 31, 2017, approximately 2,857 broker-dealers would be subject to the proposed rule 15l–3 under the Exchange Act. As discussed above, of these, approximately 802 are small entities. These broker-dealers would be subject to the rule's requirements described in the previous paragraph. As discussed above, the Commission estimates that as of December 31, 2017, approximately 7,625 investment advisers would be subject to the proposed rule 211h–1 under the Advisers Act. Based on IARD data, we estimate that as of December 31, 2017, approximately 618 advisers are small entities under the RFA. Of these, approximately 179 advise retail investors, and would therefore be subject to the proposed rule 211h–1 under the Advisers Act.

Compliance with these proposed rules would require changes to retail investor communications, which would have to be modified to incorporate the registration status in the manner the rule prescribes. As discussed above in Sections IV and V, to comply with our proposed rule with respect to print communications, broker-dealers and investment advisers would need to review their print and electronic retail investor communications, identify which would need to be amended, make the changes, and verify that all firm retail investor communications comply with the rule's requirements including its technical specifications such as the type size, font, and prominence. As discussed above in Section V, we preliminarily anticipate that the costs associated with complying with the proposed rule with respect to print communications would be larger for large broker-dealers than for small broker-dealers, because we assume large broker-dealers will have to review, identify and change more print communications and in turn have their compliance staff verify more print communications as being compliant with our proposed rule as compared to small broker-dealers which will have fewer print communications. With respect to electronic communications, broker-dealers would need to review, identify and make the required updates coupled with verifying that such retail investor communications (present and future) would be compliant with the proposed rule.[1010] We preliminarily

[1008] *See supra* Section IV.A.1.a.

[1009] As discussed in Section IV, approximately 39 percent of the 103 broker-dealers described above used a proper name coupled with the term ''advisor'' alone, and an additional 31 percent used a proper name coupled with the term ''capital advisor.'' Additionally, as discussed in the RAND Study, professionals providing advisory services or both brokerage and advisory services similarly also use a wide variety of titles, but the proportion of professionals who use titles containing the terms ''adviser'' or ''advisor'' are somewhat larger at 35%. *See supra* Section IV, Table 8: Replication of Table 6.3 of the RAND Study—Professional Titles Most Commonly Reported by Respondents, and accompanying text.

[1010] As stated in Section III.D above, we are not requiring firms to send new communications to replace all older print communications as this would be overly burdensome and costly for firms. Instead, we are staging the compliance date to

Continued

estimate that the costs associated with complying with the proposed rule regarding electronic communications would similarly be lower for small broker-dealers than for large broker-dealers, because we assume that small broker-dealers have fewer electronic communications that are subject to our proposed rule as compared to large firms. For investment advisers, as discussed above in Section V, we preliminarily estimate that large firms would require larger costs than small firms to comply with the proposed rule (*e.g.,* large firms have a greater amount of retail investor communications subject to our proposed rule that would need to be reviewed, changed, and verified).

The Commission also preliminarily estimates that the costs associated with complying with the proposed rules' disclosure requirements for broker-dealers, investment advisers, and their associated natural persons and supervised persons, respectively, would also be smaller for small firms than for large firms. With respect to broker-dealers, we estimate that the costs would increase with the size of the broker-dealer, such as costs associated with revisions to each individual representative's communication and advertising materials.[1011] Specifically, large broker-dealers would have to review, identify and change more print and electronic communications and in turn have their compliance staff verify more communications as being compliant with our proposed rules as compared to small broker-dealers which would have fewer communications. Similarly, with respect to investment advisers, we estimate that small investment advisers would have fewer print and electronic communications that would be subject to our proposed rule as compared to large firms, resulting in a lower burden preliminary estimate. In addition, the Commission estimates that small entity advisers have fewer employees performing investment advisory functions than large advisers.[1012] Therefore, we anticipate that small entity retail investment advisers would require fewer resources to oversee their employees' compliance with the proposed rule.

E. Duplicative, Overlapping, or Conflicting Federal Rules

As noted above, broker-dealers and investment advisers have other disclosure obligations under the federal securities laws and other federal laws.[1013] For example, the information required by the relationship summary is generally already provided in greater detail for investment advisers by Form ADV Part 2. The current disclosure requirements and obligations result in varying degrees and kinds of information to investors, but we believe that all retail investors would benefit from a short summary that focuses on certain key aspects of the firm and its services. By requiring both investment advisers and broker-dealers to deliver a relationship summary that discusses both types of services and their differences, the relationship summary would help all retail investors, whether they are considering an investment adviser or a broker-dealer. A relationship summary would help retail investors to understand their relationship with a particular firm, to compare different types of accounts, and to compare that firm with other firms. The relationship summary would provide in one place, for the first time, summary information about the services, fees, conflicts, and disciplinary history for broker-dealers.

Under our proposed rules, firms would be required to file their relationship summary with the Commission, and the relationship summary will be available on the Commission's public disclosure website. Dual registrants would be required to file Form CRS on both IARD and EDGAR. We are proposing IARD and EDGAR because they are familiar filing systems for investment advisers and broker-dealers.[1014] By having firms file the relationship summaries with the Commission, the Commission can more easily monitor the filings for compliance with Form CRS. We believe that requiring dual registrants to file on both EDGAR and IARD is appropriate and in the public interest and will improve investor protection. This is because retail investors seeking brokerage services (but not investment advisory services) would be likely to search EDGAR, and retail investors seeking investment advisory services (but not brokerage services) would be likely to search IARD.

F. Significant Alternatives

The RFA directs the Commission to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. We considered the following alternatives for small entities in relation to the proposed Form CRS required by Part 3 of Form ADV, the proposed amendments to Form ADV (17 CFR 279.1) and rules 203–1, 204–1, and 204–2 under the Advisers Act, the proposed new rule 204–5 under the Advisers Act, the proposed amendments to rules 17a–3 and 17a–4 under the Exchange Act, the proposed new rule 17a–14 and new Form CRS (17 CFR 249.640) under the Exchange Act, the proposed new rules 15l–2 and 15l–3 under the Exchange Act, and the proposed new rule 211h–1 under the Advisers Act: (i) The establishment of differing compliance or reporting requirements that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the proposed Form CRS, and proposed new rules and rule amendments for such small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the proposed Form CRS, and proposed rules and rule amendments, or any part thereof, for such small entities.

1. Form CRS Relationship Summary

Regarding the first alternative, the Commission believes that establishing different compliance or reporting requirements for small advisers and broker-dealers would be inappropriate under these circumstances. Because the protections of the Advisers Act and Exchange Act are intended to apply equally to retail investor clients and customers of both large and small firms, it would be inconsistent with the purposes of the Advisers Act and the Exchange Act to specify differences for small entities under the proposed rules and rule amendments. As discussed above, we believe that the proposed new Form CRS, and the proposed rules and rule amendments would result in multiple benefits to all retail investors, including alerting retail investors to certain information to consider when choosing a firm and a financial professional and prompting retail investors to ask informed questions. In addition, the content of the relationship summary would facilitate comparisons across firms. We believe that these benefits should apply to retail investors of smaller firms as well as retail

ensure that firms can phase out certain older communications from circulation through the regular business lifecycle rather than having to retroactively change them.

[1011] *See* Section IV.

[1012] Based on adviser responses to Item 5.B.(1) of Form ADV, we estimate that as of September 30, 2017, the median small entity retail investment adviser employed 1 person performing investment advisory functions, and the median non-small entity retail investment advisers employed 5 persons performing investment advisory functions.

[1013] *See supra* notes 308–316.

[1014] *See supra* Section II.C.1.

investors of larger firms.[1015] To establish different disclosure requirements for small entities would diminish this investor protection for clients of small advisers.

It would also be inappropriate to establish different recordkeeping requirements for small entities, because requiring maintenance of Form CRS and related records as part of the firm's books and records would facilitate the Commission's ability to inspect for and enforce compliance with firms' obligations with respect to Form CRS, which is important for retail investors clients of both large and small firms.

In addition, as discussed above in Section II, we are proposing to require that investment advisers and dual registrants file their relationship summaries with the Commission electronically through IARD in the same manner as they currently file Form ADV Parts 1 and 2. We are proposing to require that broker-dealers file their relationship summaries with the Commission electronically on EDGAR. As discussed above, there are several reasons we propose having the relationship summaries filed with the Commission, including that the public would benefit by being able to use a central location to find any firm's relationship summary, and that easy access to various relationship summaries through one source may facilitate simpler comparison across firms.[1016] In addition, as also discussed below, some firms may not maintain a website, and therefore their relationship summaries would not otherwise be accessible to the public.[1017] We do not believe that proposing different filing requirements for large and small firms would be appropriate given our belief that the benefits of electronic filing are important for retail investors clients and customers of both large and small firms. Furthermore, almost all advisers, including small advisers, have Internet access and use the Internet for various purposes.[1018]

Finally, the proposal to require investment advisers and broker-dealers post their relationship summary on their public websites, if they have a public website, in a way that is easy for retail investors to find, already incorporates the flexibility to permit different compliance and reporting requirements for small entities, if applicable. To the extent that broker-dealers and investment advisers that are small entities are less likely to have public websites and do not have them, they would not be required under our proposal to post the relationship summary on their websites.[1019] In other ways, as well, the proposal incorporates flexibility for smaller broker-dealers and investment advisers to comply with the proposed requirements. For instance, we are proposing to require firms to communicate the information in an amended relationship summary to retail investors who are existing clients or customers of the firm within 30 days after the updates are required to be made and without charge.[1020] This requirement provides firms the ability to disclose changes without requiring them to duplicate disclosures and incur additional costs.

Regarding the second alternative, we believe the current proposal is clear and that further clarification, consolidation, or simplification of the compliance requirements is not necessary. The proposed Instructions are designed to present requirements for advisers' and broker-dealers' relationship summaries clearly and simply to all such firms, including small entities. In addition, to aid firms in understanding the type of disclosures we propose to require, we have created mock-ups of a relationship summary for an investment advisory firm, a brokerage firm, and a dual registrant, and have included them as appendices to this release. These mock-ups examples are designed to illustrate the application of the proposed requirements. We also believe that the delivery and filing requirements are clear. As further discussed above, our proposal would require: Delivery of the relationship summary to each retail investor before or at the time of beginning a relationship with a firm,[1021] updating the relationship summary within 30 days whenever any information in the relationship summary becomes materially inaccurate,[1022] and delivery of the relationship summary to an existing retail investor client or customer at certain points during the relationship.[1023] Firms would also be required to file their relationship summaries with the Commission and post them on their firm websites, if they have a public website.

Regarding the third alternative, the Commission believes that proposed Form CRS and the related new rules and amendments appropriately use a combination of performance and design standards. We are proposing to standardize the relationship summaries among firms by specifying the headings, sequence, and content of the topics; prescribing language for firms to use as applicable; and limiting the length of the relationship summary. We believe that the standardization will provide comparative information in a user-friendly format that helps retail investors with informed decision making. For example, we are prescribing the use of graphical formats in specified circumstances, based on studies that indicate the effectiveness of graphical presentation for retail investors.[1024] Also, as discussed above, we are requiring firms to use prescribed wording in many items, and we are proposing that firms may not include disclosure in the relationship summary other than disclosure that is required or permitted by the Instructions.[1025] We believe that allowing only the proposed mandatory or permissible information would promote consistency of

[1015] *See supra* Section I (discussing the benefits of retail investors having access to diverse business models and of preserving investor choice among brokerage services, advisory services, or both).

[1016] *See supra* note 320 and accompanying text.

[1017] *Id.*

[1018] *See* 2000 Brochure Proposing Release, *supra* note 271, at n.304 and accompanying text. However, an adviser that is a small business may be eligible for a continuing hardship exemption for Form ADV filings, which would include proposed Form CRS, if it can demonstrate that filing electronically would impose an undue hardship. *See* Instruction 17 of General Instructions to Form ADV.

[1019] *See supra* note 320 (we are proposing that firms without a website include a toll-free telephone number in their relationship summaries that retail investors can call to obtain up-to-date information).

[1020] Advisers Act proposed rule 204–5(b)(4) and Exchange Act proposed rule 17a–14(c)(2)(iv4); proposed General Instruction 6.(b) to Form CRS. *See supra* Section II.C.3. Firms could communicate this information by delivering the amended relationship summary or by communicating the information another way to the retail investor. *Id.*

[1021] *See supra* Section II.C.2. We are proposing different triggers for initial delivery of the relationship summary by investment advisers (before or at the time the firm enters into an investment advisory agreement with the retail investor) and by broker-dealers (before or at the time the retail investor first engages the firm's services). These proposed requirements are intended to make the relationship summary readily accessible to retail investors at the time when they are choosing investment services and are generally consistent with the approach many commenters recommended. *Id.*

[1022] *See supra* Section II.C.3.

[1023] *See supra* Section II.C.2. For example, our proposal would require firms to communicate the information in an amended relationship summary to retail investors who are existing clients or customers of the firm within 30 days after the updates are required to be made and without charge.

[1024] For example we are proposing to require dual registrants to present all of the information required by Items 2 through 4 and Item 6 in a tabular format, comparing advisory services and brokerage services side-by-side, with prescribed headings. *See* proposed General Instruction 1.(e) to Form CRS. Similarly, standalone broker-dealers and investment advisers would be required to provide general information about fee types in tabular format, in a separate comparison section. *See* proposed Item 5 of Form CRS.

[1025] *See* supra notes 54–55 and accompanying text.

information presented to investors, and allow investors to focus on information that we believe is particularly helpful in deciding among firms.[1026]

Within the framework of standardization, we are proposing that for certain disclosure Items in Form CRS, firms would have some flexibility in how they include the required information.[1027] In addition, we have proposed permitting, but not requiring, the use of graphical formats where doing so does not unduly constrain effective description of a range of information. With respect to the prescribed wording, we are proposing that if a prescribed statement is inapplicable to a firm's business or would be misleading to a reasonable retail investor, the firm would be permitted to omit or modify that statement.[1028]

We believe that this approach of using both performance and design standards balances the need to provide firms flexibility in making the presentation of information consistent with their particular business model while ensuring that all investors receive certain information regardless of the firm in a manner that promotes comparability. In the sections above, we request comment on whether the proposed mix of design and performance standards would work for investment advisers and broker-dealers, including small entities, and what the impact of such standards would be on firms.[1029]

Regarding the fourth alternative, we believe that, similar to the first alternative, it would be inconsistent with the purposes of the Advisers Act and the Exchange Act to exempt small advisers and broker-dealers from the proposed rule and form amendments, or any part thereof. Because the protections of the Advisers Act and Exchange Act are intended to apply equally to retail investors that are clients and customers of both large and small advisers and broker-dealers, it would be inconsistent with the purposes of the Advisers Act and Exchange Act to specify differences for small entities under the proposed amendments. As discussed above, the information in the relationship summary would alert retail investors to important information for them to consider when choosing a firm and a financial professional, and would prompt retail investors to ask informed questions. In addition, the content of the relationship summary would facilitate comparisons across firms that offer the same or substantially similar services. We preliminarily believe that providing this information before or at the time a retail investor enters into an investment advisory agreement or first engages a brokerage firm's services, as well as at certain points during the relationship (*e.g.,* switching account types) is appropriate and in the public interest and will improve investor protection, and will deter potentially misleading sales practices by helping retail investors to make a more informed choice among the types of firms and services available to them. Since we view investor confusion about brokerage and advisory services as an issue for many retail investors who are clients and customers of advisers and broker-dealers, it would be inconsistent with the purpose of the relationship summary to specify different requirements for small entities.[1030]

2. Rule 15l–2 Relating to Restrictions on the Use of Certain Terms in Names and Titles

Regarding the first alternative, the Commission preliminarily believes that establishing different compliance or reporting requirements for small broker-dealers would be inappropriate under these circumstances. We believe it is important to address the risk that retail investors are confused and potentially misled based on the names or titles of their firms and financial professionals and as a result, make uninformed decisions regarding which firm or financial professional they are engaging or seeking to engage. Because the protections of the Exchange Act are intended to apply equally to retail investor clients of both large and small firms, the Commission preliminarily believes it would be inconsistent with the purposes of the Exchange Act to specify differences for small entities under the proposed rule.

Regarding the second alternative, we believe that the current proposal is clear and that further clarification, consolidation, or simplification is not necessary. As discussed in Section III above, the restriction is limited to use of the terms ''adviser'' and ''advisor.'' As discussed above in Section III, we considered whether we should restrict broker-dealers from using additional terms, such as, for example, ''financial consultant.'' We believe, however, that the term ''adviser'' or ''advisor'' is more closely related to the statutory term ''investment adviser,'' which makes it more likely than these other terms that retail investors would associate such terms with an investment adviser and its advisory activities than with a broker-dealer and its brokerage activities. We preliminarily believe that the use of the terms ''adviser'' and ''advisor'' by broker-dealers and their associated natural persons has particularly contributed to investor confusion about the typical services, fee structures, conflicts of broker-dealers and investment advisers, and legal standards of conduct to which broker-dealers and investment advisers are subject. Therefore, we believe that the current proposal is clear in its limited scope of restricted terms.

Regarding the third alternative, we believe that using performance rather than our proposed design standards would be less effective in addressing the issue of investor confusion based on the names or titles of their firms and financial professionals. As discussed in Section III, the proposed rule would restrict broker-dealers' or its associated natural persons' use of the term ''adviser'' or ''advisor'' as part of a name or title when communicating with a retail investor. We believe that the use of the terms ''adviser'' and ''advisor'' has particularly contributed to investor confusion about the typical services, fee structures, conflicts of interest, and legal standards of conduct to which broker-dealers and investment advisers are subject and as a result has potentially misled retail investors as to the type of firm or financial professional they are engaging or seeking to engage. Accordingly, we believe that restricting these terms appropriately addresses these issues based on a broker-dealer's or its associated natural persons' use of the term ''adviser'' or ''advisor'' as part of a name or title. As discussed above in Section III, we preliminarily believe that without restricting a broker-dealer or its associated natural person(s) from using ''adviser'' or ''advisor'' in a name or title, a retail investor may be misled into believing and expecting that their ''financial advisor,'' who may, for example, solely provide brokerage services at a broker-dealer, is an

[1026] It would also encourage impartial information by preventing firms from adding information commonly used in marketing materials, such as performance.

[1027] *See supra* note 56.

[1028] *See* proposed General Instruction 3 to Form CRS. Firms may omit or modify prescribed wording or other statements required to be part of the relationship summary if such statements are inapplicable to a firm's business or would be misleading to a reasonable retail investor.

[1029] *See* requests for comment in Sections II.A and II.B with respect to the proposed prescribed wording in places throughout the relationship summary, and the proposed prescribed headings, order and format.

[1030] *See supra* note 3, citing studies that show retail investor confusion about the differences among broker-dealers and investment advisers.

investment adviser (*i.e.,* a fiduciary) on the basis of his name or title.

Additionally, we considered two performance-based standards, as discussed above in Section III.C.[1031] However, we believe that either performance standard would be less effective than our proposed design standard in addressing investor confusion stemming from their association with the statutory term investment adviser. In the first alternative approach, we considered proposing a rule which would have stated that a broker-dealer that uses the term ''adviser'' or ''advisor'' as part of a name or title would not be considered to provide investment advice solely incidental to the conduct of its brokerage business and therefore would not be excluded from the definition of investment adviser under section 202(a)(11)(C) of the Advisers Act. For the second alternative approach, we considered precluding a broker-dealer from relying on the solely incidental exclusion of section 202(a)(11)(C) if it ''held itself out'' as an investment adviser to retail investors such as by representing or implying through any communication or other sales practice (including through the use of names or titles) that they are offering investment advice subject to a fiduciary relationship with an investment adviser. Under this second approach, there would be a prohibition on certain broker-dealer and its associated natural person communications that suggest, or could reasonably be understood as suggesting, that such broker-dealer or its associated natural persons are performing investment advisory services in a manner that would subject them to the Advisers Act rather than as solely incidental to their business as a broker-dealer. For the reasons we set out in Section III above, we believe that our proposed restriction on the use of ''adviser'' and ''advisor'' in combination with the requirement to deliver a relationship summary is a simpler, more administrable approach to address the confusion about the difference between investment advisers and broker-dealers, and to prevent investors from being potentially misled. As a result, we believe that our proposed approach is more tailored toward creating greater clarity than our alternative approaches.

Regarding the fourth alternative, we preliminarily believe that, similar to the first alternative, it would be inconsistent with the purposes of the Exchange Act to exempt small broker-dealers from the proposed rule, or any part thereof.

[1031] *See supra* Section III.C.

3. Rule 15l–3 Relating to Disclosure of Commission Registration Status and Financial Professional Association

Regarding the first alternative, the Commission believes that establishing different compliance or reporting requirements for small advisers and broker-dealers would be inappropriate under these circumstances. We believe it is important to assist retail investors in determining which type of firm is more appropriate for their specific investment needs and promote better informed decisions regarding which firm or financial professional they are engaging or seeking to engage. Because the protections of the Advisers Act and Exchange Act are intended to apply equally to retail investor clients of both large and small firms, we preliminarily believe it would be inconsistent with the purposes of the Exchange Act and the Advisers Act to specify differences for small entities under the proposed rule.

Regarding the second alternative, we believe that the current proposal is clear and that further clarification, consolidation, or simplification of the compliance requirements is not necessary. As discussed in Section III.D, we are proposing rules under the Exchange Act and Advisers Act that would require broker-dealers and investment advisers and their associated natural persons and supervised persons, respectively, to prominently disclose the firm's registration status with the Commission and the associated natural persons and supervised person's relationship with the firm in print and electronic retail investor communications. As discussed above in Section III, our proposal would subject broker-dealers and investment advisers to the same requirements, adding to the clarity and consolidation of the compliance requirements. Finally, we note that our proposed rules contain specific presentation and prominence requirements, as discussed above in Section III, for both print and electronic communications.

Regarding the third alternative, we believe that using performance rather than design standards would be less effective in assisting retail investors in determining which type of firm is more appropriate for their specific investment needs. Specifically, we are concerned that in the absence of the specific prominence and formatting requirements, firms and financial professionals may disclose their registration status in a footnote or at the bottom of a website and in small print as they do today with other regulatory mandated disclosures (*e.g.,* member of Securities Investor Protection Corporation). In such cases, retail investors would be unable to readily discern whether a firm is a broker-dealer or investment adviser and thus avoid making an uniformed choice of which firm or financial professional to engage or seek to engage, undermining a key purpose of our proposed rules. Therefore, we believe that our proposed design standards would facilitate the presentation of required information to retail investors. Specifically, as we noted above, disclosures as important as a firm's registration status or a financial professional's association with such firm should not be disclosed inconspicuously or placed in fine print. Accordingly, we are proposing to require a firm and its financial professionals to disclose their registration statuses in print communications in a type size at least as large as and of a font style different from, but at least as prominent as, that used in the majority of the communication. In addition, we are proposing to require the disclosure to be presented in the body of the communication and not in a footnote. Finally, we are also proposing that if a communication is delivered through an electronic communication or in any publication by radio or television, the disclosure must be presented in a manner reasonably calculated to draw retail investors' attention to it. We believe that through these design standards retail investors would have the information necessary to facilitate an informed choice of financial firm and its professionals.

Regarding the fourth alternative, we preliminarily believe that, similar to the first alternative, it would be inconsistent with the purposes of the Advisers Act and the Exchange Act to exempt small advisers and broker-dealers from the proposed rule, or any part thereof.

G. Solicitation of Comments

We encourage written comments on the matters discussed in this IRFA. We solicit comment on the number of small entities subject to the proposed Form CRS, and the proposed rules and rule amendments as well as the potential impacts discussed in this analysis; and whether the proposal could have an effect on small entities that has not been considered. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

TAB 6

Public Statement

Statement at the Open Meeting on Standards of Conduct for Investment Professionals

Chairman Jay Clayton

April 18, 2018

Today we have three separate items on the agenda. These items are a package. Collectively, they address the standards of conduct for investment professionals, and associated issues, that the Commission has been actively considering for nearly two decades now. I am excited for us to take this significant step forward. The word “step” is appropriate. Today, in short, we are framing the issues and proposing a comprehensive path forward on which we anticipate and welcome robust public comment.

My opening remarks will proceed in three parts.

- First, a brief background. While a full discussion of the 20+ year background is illuminating, I will focus on the process we engaged in over the past year to bring these proposals forward.
- Second, a discussion of the staff’s efforts, and the efforts of my fellow Commissioners, to bring us to this point.
- Third and finally, a discussion of the proposed framework and the agenda items themselves. As my full remarks will be posted online, and as we have a lot to get through this afternoon, I will abbreviate this last part of my discussion.

Background. In early 2017, as I moved through the confirmation process, it became apparent that a wide range of market participants, including retail investors, and various members of Congress believed that standards of conduct for investment professionals — or, as we like to call it, IABD, standing for “Investment Advisers and Broker Dealers”— was a matter where Commission action, including coordination with our fellow regulators, would be both appropriate and timely.

Upon my arrival at the Commission in May 2017, I consulted with my fellow Commissioners and our staff. These consultations led me to the conclusion that the Commission should lead — but not dictate — in this area. In June 2017 I issued a request for information, seeking input from the public on a range of potential issues. Since then, I have also had scores of meetings with investors, industry participants, and others across the full spectrum of these issues. While I met with many retail investors and consumer groups, I want to particularly thank the retail investors we met with in Missouri, Montana, Illinois and California, as well as those who travelled to New York for a roundtable. Your candid comments on what you expect, and do not expect, from investment professionals have resonated with me.

The comments we received since June, as well as the Commission's substantial prior work, have contributed greatly to the matters we consider today. My sincere thanks to all who took the time and effort to contribute. If we move forward today as I hope we will, I ask you to please stay engaged and that you do so with the same constructive perspective that has been present over the past nine months. I also look forward to engaging deeply and constructively with our fellow regulators, including the Department of Labor, state securities regulators and state insurance regulators, as well as FINRA. We have provided for a 90 day comment period to facilitate all those interactions. Our door is open.

The SEC Staff and My Fellow Commissioners. I will now turn to the SEC staff. You have performed in an exemplary manner. I am proud to be your colleague. The issues we address today span all of our Divisions and many of our Offices and are important to the estimated 43 million American households that have a retirement or brokerage account,[1] and the approximately 940,000 women and men in the investment advisory and broker dealer industry.[2]

I will attempt to illustrate the inter-Divisional cooperation this effort required by citing a few simple questions (there are many other important questions) and the Divisions and Offices whose expertise is essential to the answers.

Assume we change regulations affecting the standards applicable to the broker-dealer/customer relationship.

- How many individual client relationships will that change affect – both in number and type? (Division of Investment Management, or "IM"; Division of Trading and Markets, or "TM"; Division of Economic and Risk Analysis, or "DERA").
- What effect will that change in regulation have on the products available to retail investors? (IM, TM, DERA).
- Will the change lessen or increase the cost of investment advice? (IM, TM, DERA, Office of the Investor Advocate, or "OIAD").
- Will the change lessen or increase the quality of investment advice? (IM, TM, DERA).
- Will the change lessen or increase the risk of fraud and other misconduct? (IM, TM, DERA, Office of Compliance Inspections and Examinations, or "OCIE", Division of Enforcement, OIAD).
- Will the new standards be more or less in line with investor expectations? (IM, TM, DERA, Office of Investor Education, OIAD).
- Can we effectively inspect for the new standard? (IM, TM, OCIE).
- Can investment professionals that act appropriately efficiently demonstrate that they have complied with the new standard? (OCIE, IM, TM).
- Can we effectively enforce the new standard? (IM, TM, OCIE, Enforcement).

Our staff has faced these, and many other questions, head on. They have worked collaboratively and tirelessly across Divisions and Offices. They have examined these issues and — importantly — very importantly — identified guiding principles. These principles — and a great deal of high quality thought and analysis, informed by practical experience — have led to the proposed regulatory framework that we will consider today.

As an example of these guiding principles, throughout the process, the staff has focused on how best to bridge any gaps between what retail investors reasonably expect from their investment professional and what our laws and regulations require, while ensuring that investor access and investor choice are preserved. Being true to this principle should increase investor protection, as well as the quality of advice, without adversely affecting access and choice. The staff has considered each proposed component of the approach we consider today against these principles, both individually and as part of the overall package. This latter piece is important — the provisions of this package interlock with one another in many ways, and are intended to be mutually supportive. If we move forward today, this focus on guiding principles will continue, with welcome input from our fellow regulators and market participants.

My fellow Commissioners and their respective staffs also have provided very valuable input and perspective on the matters we consider today. You have my sincere thanks and respect for your efforts and views. I believe the product brought forward today is much better as a result of your constructive engagement. In this regard, while I recognize that each of us would calibrate the various aspects of the approach differently, our discussions have strengthened my conclusion that the framework of our approach is sound.

Summary of Framework and Agenda Items. The framework of our proposal is straightforward. It reflects our efforts to fill the gaps between investor expectations and legal requirements, thereby increasing investor protection and the quality of advice, while preserving investor access and investor choice, recognizing that access and choice are driven by what is available and how much it costs.

We propose to fill these gaps through (1) mandating clear disclosures — specifically, addressing how BDs and IAs identify themselves to investors and requiring them to provide investors with a standardized disclosure document of no more than four pages in length, highlighting among other things the principal services offered, legal standards of conduct that apply, fees the customer will pay, and certain conflicts of interest that exist, (2) raising the standard of conduct applicable to BDs to make it clear, among other things, that they cannot put their interests ahead of the interests of their retail customers, and (3) reaffirming, and in some cases clarifying, our views on the standard of conduct applicable to investment advisers.

This framework, along with a more detailed discussion of (1) our objectives, (2) the issues that prompted us to act, and (3) how our proposed rulemaking package advances those goals, is discussed in more detail in my posted remarks.

* * *

Before I turn it over to the staff to present their recommendations, I would like to acknowledge a few individuals, noting again, that countless current and former members of the staff contributed to this effort:

- From the Division of Investment Management: Dalia Blass, Sarah ten Siethoff, Doug Scheidt, Holly Hunter-Ceci, Sara Cortes, Jennifer Porter, Parisa Haghshenas, Roberta Ufford, Elizabeth Miller, Emily Rowland, Jennifer Songer, Gena Lai, and Ben Kalish.
- From the Division of Trading and Markets: Brett Redfearn, Lourdes Gonzalez, Emily Russell, Alicia Golden, Bradford Bartels, Geeta Dhingra, and Stacy Puente.

- From the Division of Economic and Risk Analysis: Jeffrey Harris, Vanessa Countryman, Narahari Phatak, Jennifer Juergens, Mattias Nilsson, Iulian Obreja, Dan Deli, Sai Rao, Daniel Bresler, Christo Pirinsky, Bridget Farrell, and Jeremy Ko.
- From the Office of the General Counsel: Meridith Mitchell, Lori Price, Marie-Louise Huth, Cathy Ahn, Bob Bagnall, Maureen Johansen, Monica Lilly, Michael Conley, Jeff Berger, and Dan Matro.
- From the Office of Investor Education and Advocacy: Owen Donley, Jill Felker, Vanessa Meeks, and Suzy McGovern.
- From the Office of the Investor Advocate: Rick Fleming, Brian Scholl, and Marc Sharma.
- From the Office of Compliance Inspections and Examinations: Carrie O'Brien, Jennifer McCarthy, Christine Sibille, and Aaron Russ.
- From the Division of Enforcement: Stephanie Avakian, Steven Peikin, and Dabney O'Riordan.

And now, I'd like to turn it over to Brett Redfearn and Dalia Blass, our Directors of Trading and Markets, and Investment Management, respectively, for the staff's presentation of their recommendations.

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[1] The data is obtained from the Federal Reserve System's 2016 Survey of Consumer Finances ("SCF"), a triennial survey of approximately 6,200 U.S. households and imputes weights to extrapolate the results to the entire U.S. population. As noted, some survey respondent households have both a brokerage and an IRA. Federal Reserve, *Survey of Consumer Finances* (2016), *available at* https://www.federalreserve.gov/econres/scfindex.htm.

[2] Based on staff analysis of Form U4 filings.

Related Materials

- Overview of Rulemaking Package

TAB 7

Public Statement

Overview of the Standards of Conduct for Investment Professionals Rulemaking Package

Chairman Jay Clayton

April 18, 2018

1. What are our objectives?

First, enhance retail investor protection and decision making by:

- Raising the standard of conduct for broker-dealers when they provide recommendations to retail investors, and
- Reaffirming and in some instances clarifying the terms of the relationships that retail investors have with their investment professionals.

Second, preserve retail investor access (in terms of choice and cost) to a variety of types of investment services and investment products.

Third, raise retail investor awareness of whether they are transacting with registered financial professionals.

2. What prompted us to act?

Investor Confusion Regarding the Differences Between Broker-Dealers and Investment Advisers. Broker-dealers ("BDs") and investment advisers ("IAs") both provide investment advice to retail investors, but have different relationships and are subject to various different regulatory regimes. However, it has long been recognized that many investors do not have a firm grasp of the important differences between BDs and IAs — from differences in the variety of services that they offer and how investors pay for those services, to the regulatory frameworks that govern their relationship. This investor confusion could cause investor harm if investors fail to select the type of service that is appropriate for their needs, or if conflicts of interest are not adequately understood and addressed.

The Need for Standards of Conduct That Meet Reasonable Investor Expectations and Adequately Address Conflicts of Interest. A wide array of market participants agree that, whether a retail investor engages with a BD or an IA, investment professionals should be held to a standard that meets reasonable investor expectations, including addressing conflicts of interest. Misalignment between reasonable investor expectations and actual legal standards can cause investor harm. For example, retail investors may be harmed if they do not understand when BDs and IAs may have conflicting financial interests. In addition, without sufficient clarity, retail investors may be more deferential to, or place greater reliance on, their BD or IA than they otherwise would. I believe that clarifying the legal standards of conduct that apply and reducing investor confusion through disclosure can significantly mitigate these potential harms as well as increase investor protection.

I also recognize that, in many cases, self-imposed standards and general professionalism have helped to fill any gap between reasonable investor expectations and legal standards. I applaud these long-standing efforts, but believe that proposing additional regulatory steps is necessary and appropriate. For BDs, this includes proposing to prohibit putting their interests ahead of the interests of their retail customers when making a recommendation of a securities transaction or investment strategy. For IAs, this includes clarifying that we do not believe IAs can simply "disclose away" the effect of their key duties with disclosures.

Regulatory Complexity Resulting from DOL Rule, Reduction in BD Service Offerings. In 2016, the Department of Labor ("DOL") sought to address some of these issues by deeming all investment professionals who provide investment advice to retirement accounts to be "fiduciaries" with respect to those accounts. While the status of the DOL's rule is currently in doubt following the Fifth Circuit's ruling, during the time the rule was in effect it imposed an additional standard of conduct for broker-dealers, amplifying significant regulatory complexity and uncertainty in this area, including through the introduction of multiple regulatory standards to the same investor relationship.

This action and other developments drove significant change in the market for investment advice. A number of BDs limited the products or services they provide to customers, particularly those customers with fewer assets. More specifically with respect to those services, some BDs shifted customers from full-service brokerage, which includes investment advice, to discount brokerage, which does not. Other firms that are dually registered as both BDs and IAs, as well as BDs that have an affiliated IA, shifted customers into advisory accounts, where, depending on the customer's investment strategy, they may pay more in fees for advice and services. This reduction in transaction-based service offerings has, and will continue to have, negative impacts on certain types of retail investors — for example, for buy-and-hold investors that transact infrequently, a brokerage account may be a more appropriate, and potentially less expensive account option. I believe it is important to preserve retail investors' ability to choose to receive transaction-based investment advice from BDs or portfolio-based advice from IAs and that our efforts should not increase the costs borne by retail investors.

Regulatory Complexity More Generally. Our concerns regarding regulatory complexity go well beyond the impact of the DOL rule. I am concerned that there are an increasing number of inconsistencies in the standards of conduct applicable to the provision of financial advice— in regulatory text, inspection, and enforcement— and therefore, regardless of the impact of the DOL rule, the potential for increased investor confusion and harm and decreased investor choice.

An investment professional that provides advice to an investor that has a 401(k), an annuity, and a brokerage account is subject to regulation by no less than five regulators (the SEC, FINRA, DOL, state securities regulators, and state insurance regulators). That relationship may also be subject to regulation, inspection, and enforcement by banking regulators, state attorneys general, and other state and federal regulators. This level of complexity and uncertainty undoubtedly has the potential to increase the fees paid by retail investors and reduce the availability of retail investor-oriented products and services — particularly for those investors who have fewer assets.

I believe the SEC has broad jurisdiction and decades of relevant expertise with respect to these issues, and is well-placed to bring forward an approach that can be a focal point for regulatory clarity and cooperation across the market. I also value greatly the perspective and experience of our fellow regulators, including state securities and insurance regulators. We frequently work with our state colleagues, particularly on investigations and enforcement matters, and look forward to engaging much more closely with them and our other fellow regulators as we move forward with this rulemaking process.

3. What are we doing?

I believe that we can increase investor protection and the quality of investment services by enhancing investor understanding and increasing required standards of conduct, while simultaneously preserving investor choice, through a comprehensive package of rules and guidance that includes the following:

a. Raising and Clarifying Standards of Conduct for BDs and IAs

We have a proposed rule, and a proposed interpretation, that would enhance the standard of conduct for BDs and reaffirm and, in some instances, clarify the standard for IAs, respectively. The proposed rule for BDs draws from the principles applicable to IAs to enhance existing BD standards of conduct and codify them in the SEC's regulations. As a result, our proposed rule and interpretation would impose common principles across the spectrum of relationships, while applying specific regulatory obligations that reflect the differing relationship types. In other words, while the type of advice provided, whether episodic or ongoing, may be different, the obligations to the investor should embody common best interest principles.

Proposed Rule: Regulation Best Interest.*[1]* Under this proposed rule, a BD, when making a recommendation of a securities transaction or investment strategy to a retail customer, will be required to act in the best interest of that customer at the time the recommendation is made, without placing the financial or other interest of the BD ahead of the interest of the retail customer. This best interest duty is discharged if the BD complies with a disclosure obligation, a care obligation, and two conflict of interest obligations. Specifically:

- Disclosure. The BD must reasonably disclose to the retail customer the material facts relating to the scope and terms of the relationship, including material conflicts of interest associated with the recommendation;
- Care. The BD must exercise reasonable diligence, care, skill and prudence to (A)understand the potential risks and rewards 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 and rewards associated with the recommendation; and (C) have a reasonable basis to believe that a series of recommended transactions is not excessive and is in the retail customer's best interest;

- Conflicts of Interest. The BD must establish, maintain, and enforce written policies and procedures reasonably designed to identify and then to (A) at a minimum disclose, or eliminate, material conflicts of interest associated with the recommendation; and (B) **disclose and mitigate, or eliminate**, material conflicts of interest arising from financial incentives associated with the recommendation.

This regulation prohibits BDs from putting their interests ahead of their customers' interests. While each of the component obligations of the BD's duty contributes to this outcome, the establishment of policies and procedures to mitigate or eliminate material conflicts arising from financial incentives is perhaps the most critical enhancement over existing standards applicable to BDs; it means that BDs must do more than simply disclose their conflicts of interest. We have drawn on our considerable experiences in examinations and enforcement in formulating our approach in this area. Certain inherently risky sales practices such as contests, trips, and prizes will merit scrutiny in this analysis.

Notice of Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation. As this proposed interpretation reaffirms, IAs owe a fiduciary duty to their clients. To the extent that current market conduct falls below what the Commission believes the IA fiduciary duty means, this interpretation would put the market on notice of the Commission's views.

b. Providing Clarity Regarding Fees, Conflicts and other Material Matters

Second, we have a proposed rule that contains a two-pronged approach to increasing clarity for investors. **Put bluntly, we want investors to understand who they are dealing with, i.e., what category — IA, BD, or dual-hatted— their investment professional falls into and, then, what that means and why it matters.** This proposed rule will also help highlight for investors that they are dealing with a registered entity, and that dealing with persons who are not registered raises significant risks.

Proposed Rule: Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles. This proposed rule has two major component obligations to address the "who" and "why" questions, respectively.

- Clear Labeling. The first prong, labeling, will help investors properly categorize their existing or prospective investment professional by (A) requiring BDs and IAs to be direct and clear about their legal form in communications with investors and prospective investors; and (B) restricting standalone BDs and their financial professionals from using the terms "adviser" and "advisor" as part of their names or title, which are so similar to "investment adviser" that their use by a standalone BD may mislead the BD's prospective customers.
- Fee, Conflict, and Other Material Disclosure. The second prong, disclosure, will help investors understand why the legal categories matter by requiring IAs and BDs, and dual-hatted entities, to provide investors with a standardized, short-form (4 page maximum) disclosure. The disclosure will highlight key differences in: the principal types of services offered, the legal standards of conduct that apply to each, the fees the customer will pay, and certain conflicts of interest that may exist. The disclosure will also provide customers direction as to where and how they might get more information, including on the firm's or investment professional's disciplinary history.

The disclosure — on Form CRS, or "Customer/Client Relationship Summary" — is intended to advance a layered approach to disclosure. More detailed information about an IA can be found in the IA's ADV Part 2A brochure, and more detailed information about a BD will be required through Regulation Best Interest's Disclosure Obligation.

To help IAs and BDs, as well as retail customers, begin to visualize what Form CRS would look like, we have provided mock-up forms that would be used by standalone BDs, standalone IAs, and dually-registered firms.[2]

These paper mock-ups reflect a traditional approach to how firms could choose to communicate with retail investors. Advances in communications technology provide various channels for effective communication, including, for example, interactive summaries. We also recognize that the inclusion of graphic presentations can be more effective than text only presentations. **We are proposing to allow BDs and IAs to use electronic communications and graphics to meet their Form CRS obligations, provided that such presentations are true to the content requirements and page limits of Form CRS.**

Annex A

Rule Text for Regulation Best Interest

Annex B

Form CRS Mock-up – Dual Registrant

Form CRS Mock-up – Standalone Broker-Dealer

Form CRS Mock-up – Standalone Investment Adviser

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[1] The text of Proposed Regulation Best Interest is attached hereto as Annex A.

[2] The mock-up Client Relationship Summaries are attached here to as Annex B.

Related Materials

- Annex A: Rule Text for Regulation Best Interest
- Annex B: Form CRS Mock-up – Dual Registrant
- Annex B: Form CRS Mock-up – Standalone Broker-Dealer
- Annex B: Form CRS Mock-up – Standalone Investment Adviser
- Chairman Clayton Statement at Open Meeting

TAB 8

Public Statement

Statement on Public Engagement Regarding Standards of Conduct for Investment Professionals Rulemaking

Chairman Jay Clayton

April 24, 2018

Last week, the Commission proposed for public comment a significant rulemaking package that would (1) require broker-dealers to act in the best interest of their retail customers; (2) reaffirm and in some cases clarify the fiduciary duty owed by investment advisers to their clients; and (3) require both broker-dealers and investment advisers to clarify for all retail investors the type of investment professional they are, and key facts about their relationship, as well as prohibit the use of "adviser" and "advisor" in certain circumstances, as such titles may mislead retail investors.

This rulemaking is designed to serve our Main Street investors. In particular, it is intended to bring legal requirements and mandated disclosure in line with investor expectations. I found engagement directly with retail investors and the financial professionals who serve them during the pre-rulemaking period, including a roundtable in St. Louis, to be tremendously useful. I believe we need to continue that effort by reaching out directly to investors and other market participants across the country.

I have asked the SEC staff to put together a series of roundtables, focused on the retail investor, to be held in different cities around the country — including in Atlanta, Denver, Houston, and Miami. These roundtables are intended to help us gather much-needed information straight from those who will be most directly impacted by our rulemaking. I intend to participate personally in many of these roundtables.

These efforts are one component of a broad engagement effort on this issue. For example, we invite investors to provide their views on key questions that will help us shape the disclosure designed for them. Investors may respond to these key questions using a short, fillable form. Moreover, the SEC's Investor Advocate is in the process of performing investor testing, and we anticipate making the results of that investor testing available in the public comment file.

More information about these events will be announced in the upcoming weeks. If you are interested in participating in one of these events, staff contact information will be made available in a forthcoming press release; we urge you to reach out, and we will seek to accommodate you.

TAB 9

Public Statement

Statement on Proposals Relating to Regulation Best Interest, Form CRS, Restrictions on the Use of Certain Names or Titles, and Commission Interpretation Regarding the Standard of Conduct for Investment Advisers

Commissioner Kara M. Stein

April 18, 2018

I would like to join Chairman Clayton in thanking the staff for their extremely hard work on these proposals. This truly was a Herculean task done in a very short period of time.

Over two hundred years ago, before any organized stock exchanges, twenty-four brokers came together under the leafy branches of a Buttonwood tree on Wall Street and established a new standard of conduct for stock trading. That agreement, known as the Buttonwood Agreement, was a mere two sentences long.[1] Those two sentences plainly set out the rules for stock trading and moderated the amount of commissions that could be charged to investors. The importance of those sentences cannot be overstated. That standard of conduct gave investors confidence, and brought stock trading out of the streets and coffeehouses and into stock exchanges, benefiting the entire American economy.

Today, we consider a package of proposals over 1,000 pages long, with more than 1,800 footnotes. Like the Buttonwood Agreement, this package also purports to establish a standard of conduct. Specifically, it purports to reform the way financial professionals interact with their retail clients, and to introduce new rules for financial professionals when they give advice. However, despite the hype, today's proposals fail to provide comprehensive reform or adequately enhance existing rules. In fact, one might say, the Emperor has no clothes.[2]

For at least the last decade, investors have been asking for some type of fiduciary duty standard for broker-dealers who are giving advice.[3] Unfortunately, the proposals before the Commission today squander the opportunity to act in the best interest of investors. Instead, the proposals essentially maintain the status quo.

Regulation Best Interest

Let's turn to the first of the proposed rules before us today—Regulation Best Interest. The Commission is engaging in this rulemaking because there is widespread concern that the current regulatory system for financial professionals does not adequately protect investors. Listening week after week to the Commission's enforcement staff as they discuss their investigations into fraud, deceit, and misconduct involving financial professionals, it is clear to me that existing broker-dealer standards are not sufficient. The benchmark against which we should measure the efficacy of today's proposed regulation is whether it will prevent this type of harm. Or, at a minimum, whether the proposal will make it easier for investors themselves—or the government—to help get their money back. I fear that this proposal may fall short of accomplishing either. Instead, it merely reaffirms that broker-dealers have to meet their suitability obligations,[4] requires some policies and procedures, and mandates a few disclosures. I said "reaffirms" because most of this is already required by FINRA or the federal securities laws.[5] With so much we could do to protect retail investors, it's hard to fathom why we are being asked to vote on this particular proposal today.

So what does the proposed rule do? Let's start with its name—Regulation Best Interest. This name implies that when broker-dealers give advice they will be required to put their customers' interests ahead of their own. Unfortunately, this is not the case under today's proposal.[6] Despite repeated requests to define what best interest means in the rule text, it was decided that there was no need to define it.[7]

Instead, this proposal allows a broker-dealer to meet its "best interest" obligation by doing three things: providing some "reasonable" disclosure about its relationship with the customer, fulfilling what are essentially the existing standards for broker-dealer conduct (*i.e.*, suitability),[8] and having reasonably designed policies and procedures to eliminate, or mitigate and disclose the broker-dealer's competing interests. By doing these three things, the proposed regulation protects the broker-dealer from liability or penalty, or what lawyers call a "safe harbor." It protects the broker-dealer, not the customer.

To state it differently, does this proposal require financial professionals to put their customers' interests first, and fully and fairly disclose any conflicting interests? No. Does this proposal require all financial professionals who make investment recommendations related to retail customers to do so as fiduciaries? No. Does this proposal require financial professionals to provide retail customers with the best available options? No.

Could we have proposed a best interest standard? Yes, we could have proposed such a standard.[9] Unfortunately, today we are not. We also could have made the provisions in the proposed safe harbor serve as a floor, instead of a ceiling. Instead, the proposal merely requires broker-dealers to meet certain minimal obligations in order to get the protections of the safe harbor and thus be in compliance with their "best interest standard."[10]

In addition, as I mentioned previously, because there is no definition of the best interest standard in the proposal, the name of the rule, in and of itself, is confusing. Calling the proposal Regulation Best Interest could cause retail investors to reasonably believe that broker-dealers are required to act in their clients' best interests. Perhaps it would be more accurate to call this proposal "Regulation Status Quo." Calling it Regulation Best Interest is not just confusing, it is in effect a form of mislabeling, which may be misleading and which could have deleterious consequences.[11] Indeed, one of the recommendations we are considering today is a proposal to restrict the use of the terms "advisor" and "adviser" by a broker-dealer unless it is also registered as an investment adviser. We should be logically consistent ourselves.

So what else could we have done? Well, we could have required broker-dealers to actually eliminate or mitigate conflicts of interest, instead of requiring broker-dealers to have reasonably designed policies and procedures. We could have required broker-dealers to provide "full and fair" disclosure, instead of just "reasonable" disclosure. Moreover, we could have made a few small tweaks to the current suitability standard, so that relief could be obtained for all investors when broker-dealer misconduct is widespread.[12] In sum, we could have expected more from financial professionals who provide retail investors with investment advice. If they are going to give advice in the first place, broker-dealers should truly act in the best interest of their customers given the impact this advice can have on retail investors' financial well-being.[13]

Furthermore, I am concerned that this rule will not only confuse retail investors, but also broker-dealers. In particular, the lack of a definition of best interest, the use of similar terms to mean different things,[14] the use of different terms to mean the same things,[15] and the possibility that the SEC and FINRA interpret the same language in their suitability standards differently.[16] All of these concerns would make it difficult for the industry to discern a clear compliance path. Any resulting confusion may well result in higher compliance costs for broker-dealers, which will likely be passed onto the investor. What's more, the lack of a clear standard is not likely to give investors more confidence in the broker-dealer business model.

I still have many questions regarding proposed Regulation Best Interest. Indeed, I invite the public to weigh in on the many questions, which will be contained in an appendix to this statement posted online.

Relationship Summary

The remainder of today's package, while in some respects less concerning than proposed Regulation Best Interest, nonetheless stops short of proposing meaningful change.[17] The second component of today's package concerns how investment professionals should communicate with their clients. Throughout its history, the Commission has placed reliance on full and fair disclosure as a component of its investor protection mandate. When it's done well, fair and objective disclosure is fundamental to sound decision-making. Relevant and reliable information allows the public to make informed decisions about what to purchase—whether it's a type of car, a type of milk, a type of stock, or in the case at hand, the type of financial professional to hire. Simply put, good disclosure empowers a person to decide for him or herself the appropriate course of action. However, disclosure must have the appropriate form and content. And it must be presented at the appropriate time for it to be meaningful and effective. Today's proposal is disappointing in this regard.

Today's proposal is intended to help cure investor confusion. More specifically, it is designed to help retail investors understand the difference between hiring an investment adviser versus hiring a broker-dealer. To this end, the proposal would require an investment adviser or a broker-dealer to provide a brief relationship summary to retail investors to inform them about the relationships and services it offers. The summary would also describe the standard of conduct under which the adviser or broker-dealer operates, its fees, specified conflicts of interest, and whether it has reportable legal or disciplinary events.[18] To be sure, these are areas where disclosure might help cure investor confusion. The question I have, though, is whether we are proposing disclosure that is both too generic and too legalistic such that retail investors won't bother to read it. We are all too familiar with the stilted boiler-plate jargon that riddles today's corporate disclosure documents. And we, at the Commission, understand far more about what makes disclosure effective than is evident in today's proposed rules. Take the following passage from the mock relationship summary:

> We must act in your best interest and not place our interests ahead of yours when we recommend an investment or an investment strategy involving securities. When we provide any service to you, we must treat you fairly and comply with a number of specific obligations. Unless we agree otherwise, we are not required to monitor your portfolio or investments on an ongoing basis.[19]

These three sentences are intended to describe a broker-dealer's obligation to its retail clients. But what I am asking is whether this passage would be effective in curing retail investor confusion regarding the obligation it is describing. As an initial matter, the disclosure is confusing. What does best interest mean? We may never know because Regulation Best Interest, as I described earlier, does not define what best interest means.[20] Furthermore, would this disclosure stand up to the test of a high-pressure sales situation, where the investment professional uses every tactic in the book to entice the investor to sign on the dotted line? If, as commenters have suggested in the Commission's Study on Investment Advisers and Broker-Dealers, "retail investors…find the standards of care confusing…,"[21] a simplified recitation of a broker-dealer's obligation goes only part of the way.

We should be proposing disclosure that goes a step further. The disclosure should provide a retail investor with a meaningful understanding of the ***application of the obligations to the investor***. In other words: What does best interest mean to me, in my particular situation? Or, with respect to fees, how much would I pay per year for an advisory account? How much for a typical brokerage account? What would my return be without netting fees? What would make those fees less or more? Without these types of disclosures, we will likely run the risk that a retail investor simply glances at these words and shoves them in the back of the file cabinet, or worse, the recycling bin, along with the rest of the boilerplate disclosure he or she receives.

In fact, today's proposal in some ways recognizes the inadequacy of the proposed disclosure. At the end—not the beginning—of the relationship summary is a list of "Key Questions to Ask."[22] The release states that these questions are "intend[ed] to encourage retail investors to have conversations with their financial professionals about how the firm's services, fees, conflicts and disciplinary events ***affect them***."[23]

Let's think about this for a moment. We are asking a retail investor to flip through four pages of boilerplate text, read through a series of questions, and then take the initiative to engage in a conversation with his or her financial professional about matters with which he or she may not be familiar. Why are we, in effect, placing the onus on a retail investor to cure his or her own confusion? Shouldn't we be helping financial professionals develop disclosure that would help cure such confusion? What's more, the efficacy of this approach is wholly dictated by the veracity of the financial professional's oral responses. And when you combine this with the proposal's delivery and extremely generous updating requirements,[24] I wonder if what is being proposed will actually spawn more confusion. I fear that this proposed disclosure will not only fail to add incremental value, but may also draw attention away from specific, decision-useful information.

Perhaps we could expect retail investors to flip through and take seriously four pages of boilerplate language if its presentation was visually dynamic and engaging. But, here too, the proposal falls short. And we, at the Commission, don't have any excuse, to boot. We have learned over the years—most recently at the October 2017 Investor Advisory Committee meeting[25] and the March 2017 POSITIER Evidence Summit[26]— that using certain visual, design-oriented techniques could get more investors to pay attention to the "fine print."[27] Some examples include:

- providing disclosure in the form of tables, bullet point lists, check lists, and other formats that provide greater structure and comprehensibility;
- using more white space, avoiding the temptation to overcrowd the communication;
- color-coding information to illustrate parts of the disclosure more effectively; or
- illustrating the disclosure content with visuals like icons, charts, pictograms, and other media that take it out of abstract text and ground it through imagery.[28]

What does today's proposal do on this front? It states that "firms would be ***permitted*** to use charts, graphs, tables, and other graphics or text features to explain the information, so long as the information is responsive to[,] and meets the requirements in[,] the Instructions (including the space limitations)."[29] Not especially encouraging in its use of new techniques.

I recognize that we and our staff at the Commission are not necessarily graphic artists, but we would be foolish not to at least try and capitalize on what we've learned from those who are. We could propose that the relationship summary explicitly require these elements and request comment on specific forms that may work. In fact, I invite the public to review an example—which will be posted in another appendix to this statement online—of some forms of presentation today's proposal could have utilized. I also recognize that there may be cost or administrative challenges for firms to provide more personalized disclosure. But, again, this is a proposal. If we are trying in earnest to help retail investors understand what they are getting into, we should at the very least ***try*** to sufficiently advance the ball.

Restrictions on the Use of Certain Names or Titles

The third element of today's package is a proposal to restrict a broker-dealer from using the words "adviser" or "advisor" in its name or title when communicating with a retail investor, unless the broker-dealer is a registered investment adviser. This proposal, like the relationship summary, moves in the right direction. But more can, and should be done. After all, restricting the use of only two words presents an obvious "whack-a-mole" problem.

It seems to me that a broader, more principles-based approach would prove far more effective. For example, we could preclude a broker-dealer from "holding itself out" as an investment adviser to the extent it is not an investment adviser or acting in an advisory capacity. Perhaps this could take the form contained in the money market funds rule?[30] Or it could be premised on the antifraud concept of a materially misleading statement? I welcome comment on what might be the most effective approach to achieve this end, taking into account the Commission's authority and any other legal concerns. In particular, I hope that the public provides strong empirical data that quantifies the harm to investors, individually and in the aggregate, that would occur if the Commission does not adopt a "holding out" approach.[31]

Proposed Commission Interpretation on Investment Adviser's Fiduciary Duty

The final component of today's package is a proposed Commission interpretation of the fiduciary duty owed by an investment adviser.[32] Importantly, the proposed interpretation is limited to certain aspects of an adviser's fiduciary duty under section 206 of the Advisers Act.[33] And, even then, it is not intended to be an exhaustive resource.[34] I understand that an adviser's fiduciary obligations are seen by some as ambiguous. I think clarification of the law is always a good thing. I am just a little confused as to why the Commission might be in the best position to issue interpretive guidance on an area that is heavily informed by decades of common law. I am also worried that, by limiting the interpretation to those duties under section 206, we may be, indirectly, suggesting a narrowing of an adviser's broader fiduciary duties.

Conclusion

Unfortunately, the problem we are attempting to address is an insidious one. We must remember that today's proposals will have real effects on real people.[35] After all, most investors will not realize that they should have been earning a higher return or haven't been presented with the best investment options.[36] Our decision regarding the standard to which a financial professional must be held may affect someone's ability to buy a new home, send a child to college, or retire. The impact of the proposed rules is especially important in today's era, with most employers no longer providing pension plans.[37] This makes it all the more important that we give retail investors a fighting chance. Their future depends upon us getting this right. When the question is whether to defer to financial professionals' historical practices that have caused known harm, or to give investors better disclosure and better advice, we should err on the side of the retail investor. It is the financial professionals who have the information and the ability to fix the problem—not their customers. Thus, when there is a question of where the burden of uncertainty should rest—it should rest with the more informed party—the financial professional. Unfortunately, today's package of proposals in many ways continues to place the burden on the retail investor. What's more, I believe the proposals, in their recommended forms, would make it difficult for the Commission to adopt materially improved rules going forward. As a result, I find myself unable to support today's package of proposals.

Disclaimer: This appendix reflects disclosure concepts we could have incorporated and represents my views alone and not the views of my fellow commissioners, the Commission, or the staff of the Commission.

Commissioner Stein's Take

What does "Best Interest" mean to you?

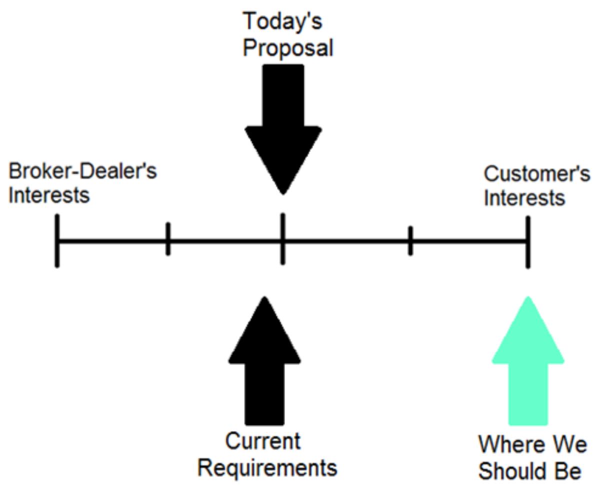

Figure 1: What does Best Interest mean?

What Regulation Best Interest does <u>not</u> do?

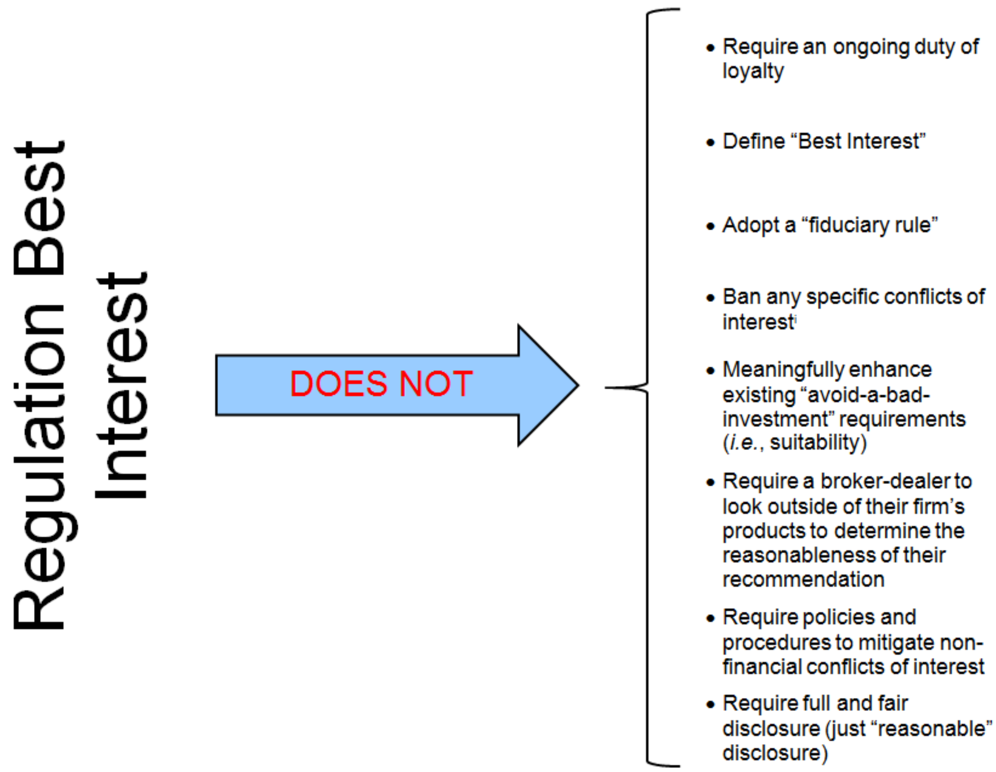

Figure 2: What this proposal does not do

What changed?

Which financial professionals are generally[ii] obligated under a fiduciary standard?	Currently	Under Today's Proposal
1. A person or company who is paid special compensation to provide investment advice (investment adviser)	✓	✓
2. A broker-dealer that recommends securities on behalf of its **retail** customers	No	No
3. A broker-dealer that recommends securities on behalf of its **institutional** customers	No	No
4. A broker-dealer who calls themselves a "wealth manager," "financial consultant," "financial manager," "money manager," "investment manager," or "investment consultant"	No	No

Figure 3: What this proposal changes

What this proposal should have done vs. what it does:

Topic Area	***This proposal should have…***	***This proposal…***
Standard of Conduct for Broker-Dealers	Required broker-dealers to actually act in a client's best interest	Gives liability protection to broker-dealers if they do a few discrete things[iii]
Defining Best Interest	Defined the term best interest in a way that holds professionals accountable	Intentionally avoids defining the term best interest
Broker-Dealer Disclosure Obligation	Required broker-dealers to "fully and fairly disclose"	Merely requires broker-dealers to "reasonably disclose"
Mitigation of Conflicts	Required disclosure and mitigation, or elimination of ALL material conflicts of interest	Requires a mitigation component in policies and procedures covering only conflicts of interest associated with financial incentives[iv]
Prohibiting Specific Conflicts	Prohibited specific conflicts of interest that incentivizes certain behavior	Does not specifically and directly prohibit certain conflicts of interest[v]
Disclosure Document	Required presentation and design standards that the Commission has learned over the past few years	Requires a disclosure document that does not incorporate lessons learned
Disclosure Timing	Required just-in-time disclosure and a five-minute waiting period to read the disclosure before a sales pitch	Follows existing rules for timing of delivery and adds lenient rules for updating disclosure
Suitability Requirement	Included an additional requirement that broker-dealers reasonably believe that the recommendation is appropriate for the category of investor to which the retail customer belongs	Generally reflects existing suitability requirements

Figure 4: What this proposal should have done vs. what it does

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i I would note that the release text suggests that there are certain conflicted practices that may be inconsistent with the obligations in Regulation Best Interest. But it is not clear to me that the release text intended this result. And if what is intended is that Regulation Best Interest does in fact include a *per se* ban on certain conflicts or practices, why have we not included that ban in the text of the rule itself? *See e.g.,* Proposing Release, at Section II.B. ("We believe that a broker-dealer would violate proposed Regulation Best Interest's Care Obligation and Conflict of Interest Obligations, if any recommendation was predominantly motivated by the broker-dealer's self-interest (*e.g.*, self-enrichment, self-dealing, or self-promotion), and not the customer's best interest – in other words, putting aside the broker-dealer's self-interest, the recommendation is not otherwise in the best interest of the retail customer based on other factors, in light of the retail customer's investment profile, and as compared to other reasonably available alternatives offered by the broker-dealer. Examples would include making a recommendation to a retail customer in order to: maximize the broker-dealer's compensation (*e.g.*, commissions or other fees); further the broker-dealer's business relationships; satisfy firm sales quotas or other targets; or win a firm-sponsored sales contest.").

ii There may be some circumstances in which a broker-dealer is not able to rely on the exception from registering as an investment adviser due to the amount of discretion they exercise over the customer's account, and therefore, would be held to a fiduciary duty. *See generally* Original rule 202(a)(11)-1 under the Advisers Act; Certain Broker-Dealers Deemed Not to be Investment Advisers, Advisers Act Release No. 2340 (Jan. 6, 2005) (Proposing Release); Certain Broker-Dealers Deemed Not to be Investment Advisers, Advisers Act Release No. 2376 (Apr. 12, 2005) (Adopting Release). The table is generally reflective of an overarching fiduciary duty governing the entire relationship.

iii *See* Proposing Release, at Section VIII. § 240.15l-1(a)(2)(i)-(iii) (describing the broker-dealer's Disclosure Obligation, Care Obligation, and Conflict of Interest Obligations).

iv Under Regulation Best Interest, broker-dealers must have policies and procedures to eliminate or disclose conflicts not associated with financial incentives, but there is no requirement for those policies and procedures to include a mitigation component unless the conflict is associated with a financial incentive.

v *See supra* note i.

Commissioner Stein's Requests for Comment

General

1. Should the Commission's proposal require financial professionals to provide their retail customers with unconflicted investment advice?
2. Should the Commission's proposal require all financial professionals to put the interests of retail customers first, before their own interests? Why or why not?
3. Should the Commission's proposal allow different standards for different groups that give investment advice to retail investors? For example, should the Commission require

investment advisers to be impartial and disinterested on an ongoing basis, but subject other investment intermediaries (such as broker-dealers) to episodic standard of conduct? Why or why not?

"Best Interest"

4. Should the Commission's proposal define what "best interest" means? Should the Commission adopt the following definition:

   > "To act in the best interest" means when a broker, dealer, or natural person who is an associated person of a broker or dealer, makes a recommendation, the recommendation reflects the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use taking into consideration all of the facts and circumstances, including the investment profile of the Retail Customer to whom the recommendation is made?

   If the Commission does not define "best interest," will broker-dealers and their customers understand their obligation?

5. How does a broker-dealer's obligations to retail customers change under the Commission's proposal? The current suitability standard requires broker-dealers to give recommendations that are in the best interest of their clients. How is the proposal different than the current standard?
6. What is the difference between the following three standards of conduct that would be applicable to broker-dealers:
   - Proposed Regulation "Best Interest" for retail customers;
   - FINRA's suitability standards for other non-institutional customers; and
   - FINRA's institutional suitability obligations for institutional customers?
7. Should dually registered advisers (broker-dealers and investment advisers) be required to tell their retail customers, in writing, when they switch between roles? For example, should retail customers be told when a registered financial adviser with a fiduciary duty switches to a financial advisor with no fiduciary duty (*e.g.*, proposed Regulation Best Interest)? Should retail customers receive notice of the implications of this change?
8. Should broker-dealers who agree to monitor their clients' accounts be subject to the proposed best interest standard? Or should they be required to register as investment advisers or held to a fiduciary standard?
9. Should broker-dealers who have discretionary authority over their customers' accounts be required to register as investment advisers or held to a fiduciary standard?
10. Should the Commission's proposed best interest standard apply only to "securities transactions" or to "transactions involving securities"?

Material Conflicts

11. Should the Commission's proposal require broker-dealers to eliminate or mitigate and disclose all material conflicts of interest? Why or why not?

12. The Commission's proposal does not prohibit any material conflicts. Should the Commission's proposal prohibit certain material conflicts of interest? Why or why not?
13. Should individual broker-dealers, as well as broker-dealer entities, be required to mitigate and disclose their conflicts of interest?
14. How is the proposed requirement for a broker-dealer to "reasonably disclose" material facts related to the scope and term of the relationship different from existing obligations under the federal securities laws, state law, and self-regulatory organization rules? Should we require broker-dealers—who possess greater information than their retail customers—to fully and fairly disclose the scope and terms of the relationship?
15. Should the "reasonableness" of a recommendation depend only upon the suite of products offered by the broker-dealer? For example, should a broker-dealer consider other products in the marketplace, such as those that are offered by other firms?

Public Interest and Investor Protection

16. Should the Commission promulgate this rule under the anti-fraud provisions of the Exchange Act?
17. Is this rule, given the safe harbor it contains, enforceable by the Commission? What proof would be necessary to bring an action? How does the safe harbor relate to the intended purpose of the rule, to ensure that broker-dealers make recommendations that are in their customers' best interest? Would there be unintended consequences?
18. How would the proposal advance the Commission's ability to obtain recompense for all the victims of widespread breaches of the suitability requirement? Would the Commission need to prove the unsuitability of the recommendation for each, of possibly thousands, of harmed customers? For instance, should the Commission have required broker-dealers to reasonably believe that the recommendation is appropriate for the category of investor to which the retail customer belongs?
19. Should the proposed "best interest" standard be confined to the safe harbor contained in the rule, or should it be a larger, more encompassing obligation?
20. Should a broker-dealer's obligation be limited to the moment in time in which the recommendation is made? Are there circumstances in which that recommendation should be updated if it has not yet been acted on?

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[1] "We the Subscribers, Brokers for the Purchase and Sale of Public Stock, do hereby solemnly promise and pledge ourselves to each other, that we will not buy or sell from this day for any person whatsoever, any kind of Public Stock, at a less rate than one quarter per cent Commission on the Specie value and that we will give a preference to each other in our Negotiations." Buttonwood Agreement, *available at* http://www.sechistorical.org/collection/papers/1790/1792_0517_NYSEButtonwood.pdf .

[2] Hans Christian Andersen, "The Emperor's New Clothes."

[3] "Nearly all U.S. investors support the fiduciary standard for investment professionals providing advice….[T]he person providing the advice should put your interests ahead of theirs and should have to tell you upfront about any fees or commissions they earn and any conflicts of interest that potentially

could influence that advice." Info Group|ORC, U.S. Investors & The Fiduciary Standard: A National Opinion Survey at 4 (Sept. 15, 2010), *available at* https://www.cfp.net/docs/public-policy/us_investors_opinion_survey_2010-09-16.pdf?sfvrsn=2 .

"More than nine out of ten (93 percent) Americans said it is important that all financial advisors be legally required to put their clients' best interests first when providing retirement investment advice", Financial Engines, *In Whose Best Interest? What Americans know and what they want when it comes to retirement investment advice* at 1 (Mar. 2016), *available at* https://financialengines.com/docs/financial-engines-best-interest-report-040416.pdf .

"An overwhelming majority of retirement account holders ages 25+…believe it is important for financial advisors to give financial advice in a client's best interest." S. Kathi Brown, *Attitudes Toward The Importance of Unbiased Financial Advice,* AARP Research (May 2016), *available at* https://www.aarp.org/research/topics/economics/info-2016/attitudes-toward-unbiased-financial-advice.html (including findings from a national survey of adults ages 25 and older conducted in 2016).

[4] *See, e.g.*, Proposing Release, Regulation Best Interest ("Proposing Release") at Section I. n.6. ("FINRA and a number of cases have interpreted FINRA's suitability rule as requiring a broker-dealer to make recommendations that are 'consistent with his customers' best interests' or are not 'clearly contrary to the best interest of the customer….'") (internal citations omitted); Proposing Release, at Section I. n.7 ("As discussed herein, some of the enhancements that Regulation Best Interest would make to existing suitability obligations under the federal securities laws, such as the collection of information requirement related to a customer's investment profile, the inability to disclose away a broker-dealer's suitability obligation, and a requirement to make recommendations that are 'consistent with his customers' best interests,' reflect obligations that ***already exist*** under the FINRA suitability rule or have been articulated in related FINRA interpretations and case law. Unless otherwise indicated, our discussion of how Regulation Best Interest compares with existing suitability obligations focuses on what is currently required under the Exchange Act.") (internal cross-references omitted) (emphasis added).

[5] I note that there are three arguable improvements in the proposed rule and the guidance in the release text. First, the definition of churning has been expanded. *See* Proposing Release, at Section II.D.2.c. And second, the rule requires policies and procedures reasonably designed to mitigate certain material conflicts of interest arising from financial incentives associated with recommendations. *See* Proposing Release, at Section II.D.3. Finally, there may be some benefit to consolidating certain provisions that apply to broker-dealers under one federal regime. However, I do not believe that these modest improvements overcome the harm caused by the confusion over what "best interest" means.

See Proposing Release, at Section I.A. ("As noted, broker-dealers are subject to comprehensive regulation under the Exchange Act and SRO rules, and a number of obligations attach when a broker-dealer makes a recommendation to a customer. Under the federal securities laws and SRO rules, broker-dealers have a duty of fair dealing, which, among other things, requires broker-dealers to make only suitable recommendations to customers and to receive only fair and reasonable compensation. Broker-dealers are also subject to general and specific requirements aimed at addressing certain conflicts of interest, including requirements to eliminate, mitigate, or disclose certain conflicts of interest."); Section I.A. nn.9-14; Section II.D n. 175 ("Exchange Act Rule 10b-10, which generally requires a broker-dealer effecting customer transactions in securities (other than U.S. savings bonds or municipal securities) to provide written notification to the customer, at or before completion of the transaction, disclosing information specific to the transaction, including whether the broker-dealer is acting as agent or principal and its compensation, as well as any third-party remuneration it has received or will receive. 17 CFR 240.10b-10. *See also* Exchange Act Rules 15c1-5 and 15c1-6, which require a broker-dealer to disclose in writing to the customer if it has any control, affiliation, or interest in a security it is offering or the issuer of such security. 17 CFR 240.15c1-5 and 15c1-6. There are also specific, additional obligations that apply, for example, to recommendations by research analysts in research reports and to public appearances under Regulation Analyst Certification (AC). *See, e.g.,* 17 CFR 242.500 *et seq*. Finally, SRO rules apply to specific situations, such as FINRA Rule 2124 [Net Transactions with Customers]; FINRA Rule 2262 [Disclosure of Control Relationship with Issuer], and FINRA Rule 2269 [Disclosure of Participation or Interest in Primary or Secondary Distribution]."); Section II.D. n.176 (noting that "[b]roker-dealers are liable under the antifraud provisions for failure to disclose material information to their customers when they have a duty to make such disclosure"; that "a broker-dealer's duty to disclose material information under the antifraud provisions is broader when the broker-dealer is making a recommendation to its customer"; and that "broker-dealers generally are liable under the antifraud provisions if they do not give 'honest and complete information' or disclose any material adverse facts or material conflicts of interest, including any economic self-interest.") (internal citations omitted); Section II.D.1.c. n.207 ("For example, the Commission has indicated that failureto disclose the nature and extent ofa conflict of interest may violate Securities Act Section 17(a)(2)."); Section II.D.1.c. n.208 (noting that brokers must give "honest and complete information when recommending a purchase or sale"); Section II.D.2.b. n.239 (noting that, "a broker's recommendation must be suitable for the client in light of the client's investment objectives", that brokers must only make recommendation for which they have "reasonable grounds to believe me[e]t the customers' expressed needs and objectives.").

[6] Proposing Release, at Section II.A. ("In other words, the broker-dealer's financial interest can and will inevitably exist, but ***these interests cannot be the predominant motivating factor*** behind the recommendation.") (emphasis added); Proposing Release, at Section II.B. ("We believe that a broker-dealer would violate proposed Regulation Best Interest's Care Obligation and Conflict of Interest Obligations, if any recommendation was ***predominantly motivated by*** the broker-dealer's self-interest (*e.g.*, self-enrichment, self-dealing, or self-promotion) . . . ."") (emphasis added).

[7] Proposing Release, at Section II.B. ("We are not proposing to define 'best interest' at this time.").

[8] To make matters worse, we are allowing the reasonableness of their recommendations to be judged only by the products that they themselves offer, not by what they could have reasonably offered. There is ***no*** obligation to present the ***best*** available options. Proposing Release, at Section II.B. ("broker-dealers generally should consider reasonably available alternatives offered by the broker-dealer as part of having a reasonable basis for making the recommendation").

[9] *See* Section 913(g) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 (2010), *available at* https://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf ("The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.").

For instance, we could have defined "to act in the best interest" to mean that when a broker, dealer, or natural person who is an associated person of a broker or dealer, makes a recommendation, the recommendation reflects the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use taking into consideration all of the facts and circumstances, including the investment profile of the retail customer to whom the recommendation is made.

[10] Proposing Release, at Section VIII. § 240.15l-1(a)(2) (noting that "[t]he best interest obligation in paragraph (a)(1) shall be satisfied ***if***" the broker-dealer provides reasonable disclosures about the scope and terms of the relationship, fulfills the suitability standard, and has policies and procedures regarding conflicts of interest) (emphasis added).

[11] In other contexts, there are rules prohibiting deceptive or misleading names. For example, Section 35(d) of the Investment Company Act of 1940 ("Investment Company Act") makes it "unlawful for any registered investment company to adopt as a part of the name or title of such company . . . any . . . words that the Commission finds are materially deceptive or misleading. . . ." In this context, mutual funds cannot include a type of investment or industry in the fund name without "adopt[ing] a policy to invest, under normal circumstances, at least 80% of the value of its Assets in the particular type of investments, or in investments in the particular industry or industries, suggested by the Fund's name." *See* rule 35d-1 under the Investment Company Act [17 C.F.R. § 270.35d-1].

[12] For example, we could have required broker-dealers to reasonably believe that their recommendation are not only suitable for "some customer," but for the category of customer to which the retail customer belongs.

[13] For instance, the Commission has explained the impact of fees on investment portfolios: "fees may seem small, but over time they can have a major impact on your investment portfolio. . . . In 20 years, 1.00% annual fees reduce [a $100,000] portfolio . . . by $30,000 compared to a portfolio with a 0.25% annual fee." SEC, Updated Investor Bulleting: How Fees and Expenses Affect Your Investment Portfolio, September 8, 2016, *available at* https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/updated-investor-bulletin-how-fees-expenses-affect.

[14] Proposing Release, at Section II.C.4. ("The proposed definition of 'retail customer' also differs from the definition of 'retail investor' proposed in the Relationship Summary Proposal. . . .").

[15] Proposing Release, at Section II.A. ("We request comment below, however, on whether our proposed rule should instead incorporate the 'without regard to' language set forth in Section 913 and the 913 Study recommendation, which we believe would also generally correspond to the DOL's language in the BIC Exemption, but interpret that phrase in the same manner as the 'without placing the financial or other interest . . . ahead of the interest of the retail customer' approach set forth above.") (quoting the rule text in Regulation Best Interest in the second instance).

[16] Proposing Release, at Section I.B. n.89 ("Generally, when a requirement of proposed Regulation Best Interest is based on a similar SRO standard, we would expect – at least as an initial matter – to take into account the SRO's interpretation and enforcement of its standard when we interpret and enforce our rule. At the same time, we would not be bound by an SRO's interpretation and enforcement of an SRO rule, and our policy objectives and judgments may diverge from those of a particular SRO. Accordingly, we would also expect to take into account such differences in interpreting and enforcing our rules.").

[17] Today's proposals have been presented as a package of interrelated rules and form changes. For this reason, while there will be distinct votes on each recommendation, I view today's proposals as they have been presented—as a singular package of proposals.

[18] *See* Proposing Release, Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles ("CRS Proposing Release"), at Section II.

[19] *See* Proposed Broker-Dealer Mock Relationship Summary. *See also* Proposed Form ADV, Part 3: Instructions to Form CRS ("Proposed CRS Instructions"), Item 3.B.

[20] *See supra* note 7 and accompanying text.

[21] Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("913 Study"), *available at* www.sec.gov/news/studies/2011/913studyfinal.pdf, at v.

[22] *See* Proposed CRS Instructions, Item 8.

[23] CRS Proposing Release, at Section II.B.8. (emphasis added).

[24] *See* CRS Proposing Release, at Sections II.C.2. and II.C.3. The proposal would require a firm to update its relationship summary within 30 days whenever the relationship summary becomes materially inaccurate. It is not clear to me why we would propose to allow financial professionals 30 days to update generic disclosure.

[25] *See* Discussion Regarding Electronic Delivery of Information to Retail Investors Investor as Owner Subcommittee, SEC Investor Advisory Committee (Oct. 2017), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac101217-agenda.htm.

[26] *See* Press Release, *SEC's Office of the Investor Advocate to Hold Evidence Summit, Launch Investor Research Initiative* (Mar. 2, 2017), *available at* https://www.sec.gov/news/pressrelease/2017-59.html.

[27] In this proposal, the Commission fails to consider its own guidance to "assure[] the orderly and clear presentation of complex information so that investors have the best possible chance of understanding it." *See* A Plain English Handbook: How to Create Clear SEC Disclosure Documents, Office of Investor Education and Assistance, U.S. Securities and Exchange Commission, at 5 (Aug. 1998), *available at* https://www.sec.gov/pdf/handbook.pdf.

[28] *See, e.g.*, Margaret Hagen, *Designing 21st-Centurey Disclosures for Financial Decision Making*, Stanford Law School and Policy Lab (2016), *available at* https://law.stanford.edu/wp-content/uploads/2016/10/Hagan-Designing-21st-Century-Disclsoures-for-Wise-Financial-Decision-Making-FINAL-2016.pdf .

[29] CRS Proposing Release, at Section II.A (emphasis added).

[30] *See* rule 2a-7 under the Investment Company Act [17 C.F.R. § 270.2a-7].

[31] This analysis should assume and incorporate the changes being proposed pursuant to Regulation Best Interest, in Form CRS, and the labeling restrictions currently in the proposal.

[32] The related release also requests comment on licensing and continuing education requirements for personnel of SEC-registered investment advisers; delivery of account statements to clients with investment advisory accounts; and financial responsibility requirements for SEC-registered investment advisers, including fidelity bonds. *See* Proposing Release, Proposed Commission Interpretation

Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation ("Fiduciary Proposing Release"), at Section IV.

[33] *See* Fiduciary Proposing Release, at Section I. *See also* Section 206 under the Investment Advisers Act of 1940 [15 U.S.C. § 80b-6].

[34] *See* Fiduciary Proposing Release, at Section I, n.7.

[35] Letter from Consumer Federation of America to Jay Clayton (Sep. 14, 2017), pp. 29-31, *available at* https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2447346-161075.pdf; Bob Veres, The Awful Consequences of Non-Fiduciary Advice, INSIDE INFORMATION, *available at* http://www.bobveres.com/uncategorized/the-awful-consequences-of-non-fiduciary-advice-2/ .

[36] The White House Council of Economic Advisers estimated that "conflicted advice leads to lower investment returns. . . . [and] . . . . large and economically meaningful costs for Americans' retirement savings" with estimates of the total annual cost associated with retirement savings exceeding $17 billion. The Effects of Conflicted Investment Advice on Retirement Savings, February 2015, *available at* https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf. Others have estimated the harm from conflicted investment advice to be $20 to $40 billion per year (Consumer Federation of America 2017 letter, *available at* https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2447346-161075.pdf), and $21 billion per year (Letter from Marnie C. Lambert, President, Public Investors Arbitration Bar Association (Aug. 11, 2017), *available at* https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2215713-160615.pdf).

[37] "Many individuals report that they have no retirement savings, and—among those who are saving—a number of respondents indicate that they lack confidence in their ability to manage their retirement investments." Federal Reserve System Board of Governors, Report on the Economic Well-Being of U.S. Households in 2015 (May 2016), *available at* https://www.federalreserve.gov/2015-report-economic-well-being-us-households-201605.pdf.

TAB 10

Public Statement

Statement at Open Meeting on Form CRS, Proposed Regulation Best Interest and Notice of Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers (Proposed Rule)

Commissioner Michael S. Piwowar

April 18, 2018

I would like to start by thanking the Directors of the Divisions of Investment Management and Trading and Markets for their joint leadership in devising the package of recommendations before us this afternoon. Each of these recommendations, in its own way, seeks to address confusion among retail investors about the disparate regulatory regimes governing investment advisers and broker-dealers.

Of course, resolving this confusion is no easy task, as I am sure Dalia [Blass] and Brett [Redfearn] will each attest. From their earliest days on the job, it was clear that they were each committed to working together to seek potential solutions in an area that has vexed both the Commission and other regulators for years.

While Dalia and Brett charted the course for this project, it could not have been accomplished without the hard work of their respective staffs. These teams spent countless hours analyzing comment letters, meeting with industry participants, and drafting these weighty documents. And I do mean weighty — it took two giant four-inch binders to hold the copy of this package they delivered to my office. Further thanks go to the staff in the Division of Economic and Risk Analysis and the Office of General Counsel, who provided critical input along the way.

Finally, and most importantly, thank you to Chairman Jay Clayton for pledging the SEC to act in this area, where our leadership has been sorely needed. Chairman Clayton has constantly reminded us that today's recommendations are not really about investment advisers and broker-dealers; they are about the retail customers they serve. Last week, I joined SEC staff in talking to a group of 200 U.S. Marines at Camp Pendleton — some of them straight from boot camp — about saving and investing for the future. It is not lost on me that those Marines are dedicating their lives so that we can be secure in our liberties. The least we can give them is the tools they need to secure their financial future. These are the investors we must have in mind as we design rules to clarify and improve the standards of conduct across the investment adviser and broker-dealer industries.

We cannot discuss standards of conduct without acknowledging the proverbial elephant in the room: the Department of Labor ("DOL") Fiduciary Rule. In 2015, the DOL acted unilaterally to pass what I have described as a "terrible, horrible, no good, very bad" rule,[1] ignoring input from the SEC staff (including that from our knowledgeable economists), FINRA, state securities regulators, and state insurance regulators. DOL's hasty approach drew immediate backlash. The only thing clear about that rule was that it would drive up compliance costs for broker-dealers and insurance providers to the point where many investors would be left without access to the affordable financial advice that these business models can offer. Thankfully, for the sake of retail investors — or as Chairman Clayton likes to say "Mr. and Mrs. 401(k)" — the Fifth Circuit called out the DOL's highly questionable use of authority and vacated its rule.[2] Now, all eyes are on the SEC as we seek to provide a workable, non-political path forward.

That is why I am happy to support all three of today's recommendations. Nevertheless, I cannot hide my misgivings about certain aspects of the nearly 1,000 page tome before us today. The size of this package alone gives me pause. If it takes us that many pages to explain what we are trying to do, dare I say that our solution might necessarily lack the clarity that is needed to address retail investors' confusion? With that overarching concern off my chest, I will now discuss my views on each of the three proposals in turn.

I. Form CRS

Form CRS would require financial professionals to deliver to their retail customers a short and simple disclosure form to clarify the scope of these customers' relationships with those people and companies who offer them financial services.

This type of disclosure-based regulation is premised on standard economic theory supporting the notion that disclosure can solve information asymmetries. Indeed, one of the primary failings of the DOL rule was that it dismissed the efficacy of conflict of interest disclosure, in stark contrast to decades of Commission experience.[3]

While I support the spirit of today's Form CRS proposal, it is evident that our relationship summary templates — as proposed — are in need of substantial public input. These summaries are meant be clear and concise, and to read like 'plain English.' Yet the Flesch-Kincaid readability calculator shows that they are about as comprehensible to the average reader as Herman Melville's *Moby Dick*. This makes sense, considering that the SEC staff who drafted them are securities lawyers and Ph.D. economists. However, it does not make sense if our true goal with these forms is to help retail customers break through the confusion that can cloud their interactions with broker-dealers and investment advisers. That is why I hope to hear from a wide range of commenters — including consumer behavior researchers in fields such as economics, marketing, and advertising — who can each help us make these disclosure forms more effective at conveying information in a way that retail investors can understand. I also look forward to the results of investor testing, which our Office of Investor Advocate will conduct, related to this topic.

Lastly, on this proposal, I am thrilled that we are finally addressing the specific confusion and resultant potential harm to retail investors from the use of misleading titles by financial professionals. As the proposal on Form CRS notes, retail investors must be able to distinguish between the types of financial service providers they can choose to deal with, including those who sell products and those who offer full-service advice as a fiduciary. But currently, the titles used by many of these financial services providers offer investors little to no help. For example, under current regulations anyone can call him- or herself a financial "adviser" (or "advisor"), regardless of whether they are a registered investment adviser complying with all of the investor protections such registration entails.

So it is hard to argue with the comedian and television host John Oliver who, while dedicating an entire episode of his show "Last Week Tonight" to this issue, pointed out that the "term [financial adviser] doesn't necessarily mean much."[4] In fact, you may not have known, but in addition to being a Ph.D. economist and SEC Commissioner, I recently earned a "Bachelor of Financial Advising" from the "Financial Advisor Academy." In fact, "Dean of Financery" John Oliver himself (well, at least his website) bestowed me that title, and I have a certificate with his signature to prove it.

While today's proposal would ultimately limit my "financial advising" activities, I am willing to make that personal sacrifice in order to ensure greater clarity for retail investors.

II. Regulation Best Interest ("Reg BI")

As I mentioned previously, I have been eager for the SEC to take the lead in offering a regulatory alternative to the DOL Fiduciary Rule. While I have kept an open mind as to what that alternative should be, I strongly believe that whatever the Commission ultimately adopts must (1) be *clear* about the new obligations we are imposing, and (2) not be so restrictive or difficult to comply with that firms stop offering retail investors services they can pay for through commissions or other transaction-based fees. Today's proposal of Reg BI is a solid building block towards those ultimate goals.

This proposal imposes on broker-dealers a new “best interest” standard. This sounds simple enough — it’s not merely a “good” interest or a “better” interest standard, it is a “best” interest standard — and that term has attracted many advocates within the industry. However, as everyone who has worked on this rulemaking knows, the devil is truly in the details. According to the proposing release, this “best interest” standard is wholly different from the well-established Investment Adviser’s Act fiduciary standard and FINRA’s suitability standard. Unfortunately, after 45 days of reviewing and commenting on this release, I am not convinced that we have clearly and adequately explained the exact differences.

This lack of clarity is worrisome and could undermine our goal of preserving retail investors’ ability to access different types of financial services. On a basic level, ambiguity in this rule would make it difficult for broker-dealers to know how to comply with its requirements, which could then lead to disparate treatment of retail investors or a decision to stop offering transaction-based services.

At the same time, uncertainty about our requirements would also make the rule more costly to implement. As Chairman Clayton accurately stated in his speech setting out his guiding principles: “the costs of a rule now often include the cost of demonstrating compliance.”[5] I fear that despite the laudable goals of proposed Reg BI, ambiguity in its requirements could make demonstrating compliance particularly challenging.

We must remember that any implementation challenges and compliance costs created by these new Reg BI obligations add to those that broker-dealers already bear when complying with other regulators’ requirements — namely those from FINRA, the DOL, state securities regulators, and state insurance regulators. So we must ask ourselves, and I encourage commenters to respond to the same question: Will Reg BI raise compliance costs to such a level that it becomes economically disadvantageous for broker-dealers to offer retail investors transaction-based advice?

Despite these concerns, I am supporting this proposal because I believe it is a very positive step towards furthering the Commission’s goal of better aligning broker-dealers’ obligations to the expectations of their retail customers by: (1) requiring broker-dealers and registered representatives to not place their interests ahead of their retail customers’; (2) protecting retail customers from investment strategies that drive up broker-dealers’ fees; and (3) requiring broker-dealers to provide their customers with enhanced disclosures of conflicts of interest.

We must now rely on commenters to let us know how well we have articulated the new best interest standard, and how we might be able to modify or clarify it to better accomplish these stated goals. Particularly, should we have more explicitly adopted FINRA’s suitability standard, which has been interpreted as having a “best interest” requirement, into the Commission rulebook? With regard to disclosures, should we have sought to consolidate Reg BI’s disclosure requirements with those mandated by Form CRS? Responses to these and other questions in the release will help us tailor our final rules to prevent unnecessary ambiguity and unintended consequences.

I trust that this proposal will launch a vigorous discussion, and I look forward to the feedback we will undoubtedly receive.

III. Notice of Proposed Interpretation Regarding Standard of Conduct for Investment Advisers

Finally, we are proposing an interpretation of the standard of conduct for investment advisers. This issue has not received nearly the same scrutiny as the broker-dealer standard of conduct in recent years, but it is no less important. Most people in this room would immediately be able to identify the “fiduciary duty” as the standard of conduct for investment advisers. What may not be as readily identifiable are its parameters. Put another way, what specifically does the fiduciary duty entail?

Such a question should not surprise us, as the Advisers Act prescribes few particular obligations related to this standard. As a result, the proposed interpretation infers certain requirements from common law principles and generally cites to treatises and law review articles for support. However, the relative lack of case law underpinning this proposed interpretation raises questions about our legal authority to issue this guidance. I recognize that many of these proposed requirements have become industry standard practices in response to Commission orders in settled enforcement actions. But, settlements are not legal precedent. While I am pleased that we did not seek to rely on settled orders as support for this guidance, I am eager to know what legal authority exists to support the interpretation of advisers’ fiduciary duty that we are proposing today.

While I am not opposed to proposing this guidance for comment, I hope that commenters will fill in any gaps in our analysis to bolster the common law support for the propositions in this document. Where we find that such support is not available, yet still believe that certain obligations merit the imprimatur of the Commission, we should consider engaging in rulemaking rather than attempting to impose requirements through guidance.

IV. Conclusion

In summary, while I have some misgivings about certain aspects of all three recommendations, I overwhelmingly support putting them out for public comment. No longer can anyone say “The SEC really needs to do something about this.”

Thank you. I have no questions.

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[1] Commissioner Michael S. Piwowar, “Comment Letter in Response to the Department of Labor’s “Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions” (July 25, 2017) (“DOL Comment Letter”), https://www.sec.gov/news/public-statement/piwowar-comment-dol-fiduciary-rule-prohibited-transaction-exemptions.

[2] *Chamber of Commerce of the United States v. United States DOL*, 2018 U.S. App. LEXIS 6472 (5th Cir. 2018).

[3] DOL Comment Letter.

[4] *See* Last Week Tonight with John Oliver (HBO), “Retirement Plans” (June 13, 2016).

[5] Chairman Jay Clayton, “Remarks at the Economic Club of New York” (July 12, 2017), https://www.sec.gov/news/speech/remarks-economic-club-new-york.

TAB 11

Proposed Rulemakings and Interpretations Relating to Retail Investor Relationships with Investment Professionals

Commissioner Robert J. Jackson Jr.

April 18, 2018

Thank you, Chairman Clayton, and thank you to the exceptional Staff in the Divisions of Trading and Markets and Investment Management for their work on these proposals. As my colleagues have noted, today's proposals have been decades in the making, and I am especially grateful to Director Dalia Blass and her wonderful colleagues Sarah ten Siethoff, Doug Scheidt, Sara Cortes, Holly Hunter-Cecil, Jennifer Porter, Emily Rowland, Jennifer Songer, Parisa Haghshenas, Benjamin Kalish, Roberta Ufford, Elizabeth Miller and Gena Lai, and our Trading and Markets colleagues Brett Redfearn, Lourdes Gonzalez, Emily Russell, Alicia Goldin, Bradford Bartels, Geeta Dhingra, Stacy Puente, and Roni Bergoffen for bringing these proposals before the Commission.

After years of tireless advocacy and relentless lobbying, the Commission today finally steps forward to propose a framework for protecting the millions of American families who rely on professional advice to save for education and retirement. The proposals offer a sliver of hope that the SEC will finally fill an enormous gap in our securities laws between the protections those families deserve and the legal obligations of financial professionals—a gap we have allowed to persist for far too long.[1]

Let me be clear: I could not support these proposals if we were today considering making them final agency rules. Commissioner Stein has explained the problems with the proposals far more eloquently than I can, and I point my colleagues to the thoughtful statement she issued today. Yet the need for SEC action in this area has been made all the more urgent by the Administration's refusal to implement the crucial protections put in place by the Department of Labor in 2016[2] and the profoundly misguided recent judicial decision jeopardizing those protections.[3] I strongly support the Department of Labor's rule because it protects investors from the very real costs of conflicted financial advice. But without an Administration willing to enforce it or courts willing to take the realities American families face seriously,[4] as we sit here today investors lack protections against so-called advisors who might endanger their financial future.

The Commission can and should provide the protections those investors so urgently need, so today I am reluctantly voting to open these proposals for comment—and to continue the conversation about how best to protect Americans' financial futures from conflicted advice. I want to identify four areas where any final rule should be significantly improved—and urge commenters to help make sure that the work we begin today ends with nothing less than the common-sense protections investors deserve.

* * * *

First, the standard set forth in Regulation Best Interest is far too ambiguous about a question on which there should be no confusion: the duty that investors are owed by those who are entrusted with ordinary families' economic futures. Americans deserve a clear best interest rule that places the client's needs ahead of the broker's. Period. There are, of course, many ways to write one—we could have, and should have, simply started with the standard Congress articulated in the Dodd-Frank Act.[5]

As written, the standard is potentially confusing, and I worry that it may be interpreted to permit conflicted advice to taint the investment decisions crucial to Americans' futures. Moreover, I worry that lawyers will use this ambiguity to defend broker conduct that has no place in our markets—a result that is good for brokers and their lawyers but not for investors.

Second, I am deeply concerned about the extent to which today's proposal actually strengthens the so-called suitability standard that has for so long failed to protect investors from conflicted brokers. As the Department of Labor's detailed study of these questions made clear, the application of the suitability standard has too often left American families holding the bag while brokers pursue profit at investors' expense,[6] and we should be leaving no doubt that those decisions will play no role in the application of Regulation Best Interest. I appreciate that the proposal says that "our intent [is] to make it clear that, insofar as existing broker-dealer obligations have been interpreted to stand for the principle that broker-dealers may put their own interests ahead of their retail customers . . . those interpretations would be inconsistent with Regulation Best Interest."[7] But I urge commenters to explain how we can be even clearer that the standard in Regulation Best Interest raises the bar for the brokers who serve American investors.

Third, while requiring mitigation of broker conflicts is an important step forward, we cannot and should not rely solely on mitigation to address the most egregious practices that are pervasive in this industry. Many of the most harmful conflicts in the market today are created by the firms themselves through practices—like sales contests, quotas, and bonuses for selling proprietary products—that make little sense for investors.

I don't think these practices have any place in a market built to serve investors instead of brokers. That's why I believe that many of them should be banned outright. Today's proposal makes clear that these practices "may be more appropriately avoided in their entirety for retail customers."[8] I appreciate the important message the Commission is sending today by identifying these especially perverse incentives that ultimately harm investors—and urge commenters to help us identify the practices we need to eliminate from American markets for good.

Moreover, it's important that these proposals contain restrictions on brokers' ability to use the titles adviser and advisor, or to mislead investors through advertisements or communications regarding the nature of their services.[9] A robust final rule in this area should address brokers' ability to hold themselves out as advisors in a misleading manner.

Finally, the cost-benefit analyses in these proposals do not reflect a serious attempt to evaluate the effects of our choices on real-world investors. The courts can, and should, defer to the Commission's cost-benefit analysis so that the important work of assessing the economics of regulation is left in the hands of the experts.[10] The cost-benefit analyses in these proposals, however, are so slight that we should not expect, nor do we deserve, that deferential review. Comparing today's proposals to the research the Department of Labor conducted has convinced me that I will be unable to support a final rule in this area unless we do more to understand how our proposal will actually affect investors.

For starters, the proposals before us ignore much of the economic literature that academics and policymakers have generated in this area for decades. To know whether the disclosures in our proposed Customer Relationship Summary will be helpful, for example, we need to know how investors will respond to these disclosures. Will investors understand the implications of what they see on Form CRS? To what degree will investors actually use that information when making the crucial decision as to who to trust with their money? There is ample literature on questions like those, and indeed our exceptional Staff has long expressed skepticism about whether and how disclosure might work in this area.[11] But little of that evidence has been seriously considered in the analysis before us today.[12]

What's more, the Department of Labor helpfully collected that literature in what may have been the most extensive regulatory impact analysis in the history of federal rulemaking.[13] The Department then took those empirical findings and formulated predictions about the effects of rules in this area for retail investors.[14] Given that these data are available, we could have—and should have—formulated a range of assumptions that would have allowed us to meaningfully understand the costs and benefits of what we are proposing to do. Instead, the proposal before us today deals with years of research conducted by a companion federal agency in a single dismissive footnote.[15]

Perhaps the most glaring omission from our economic analyses is the absence of any attempt to assess the benefits of honest advice for ordinary investors. I counted seventeen occasions on which this proposal says that we are unable to quantify those benefits, as if our inability to calculate them precisely absolves us of our responsibility to calculate them at all.[16]

As the agency charged with protecting America's investors, we must do more to understand the effects of this proposal on those we serve—and that work should start today. For example, we should test how investors will respond to the disclosures we're proposing. We should conduct experiments to understand how broker-dealers will alter their recommendations in response to our rules. And we should survey market participants, from the largest institutions to the smallest retail investors, about whether and how they understand their legal rights and responsibilities. Without that work, we will have no basis to know whether we are doing the right thing for investors and for the Nation. And we will inflict the unnecessary costs of significant uncertainty if our rules face legal challenges.

* * * *

These are just a few of my concerns with today's proposals—and I expect that commenters will identify many more. But I am mindful of the fact that, in light of recent decisions by the Administration and the courts, investors currently lack any meaningful protections from conflicted advice from brokers. And I believe that an open, public rulemaking process is the best way for us to be certain that our rules are giving investors the protections they deserve. For that reason, I am reluctantly voting to issue these proposals for comment—and look forward to continuing to work with our exceptional Staff to improve them.

This work is hard. In a world rife with a dizzying array of ever-more-complex financial products, America's families need honest financial advice more than ever. Protecting those families from the devastating consequences of advice that serves financial professionals rather than their clients' futures is not easy. That's why I'm inspired by the dedication it took our Staff to bring these proposals before us—even though today is only the beginning of the conversation.[17]

This area has become the subject of such intense advocacy that it is easy to forget what really brought us all here today. Millions of Americans are approaching retirement age, and most of them don't have the pensions that protected their parents from rising medical and housing costs.[18] Instead, they must rely on financial advice to help them plan for a secure future. For these Americans, getting the right advice can be the difference between a secure retirement and a life of constant worry.

I am grateful to the Staff for all they have done to get us to today—and look forward to the public comments that will be crucial to making sure that we get this right.

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[1] *See, e.g.*, Report of the Committee on Compensation Practices (Tully and Levitt, 1995) (describing the lengthy history in this area).

[2] *See* Release, United States Department of Labor, *U.S. Department of Labor Extends Transition Period for Fiduciary Rule Exemptions* (November 27, 2017).

[3] United States Chamber of Commerce v. Dep't of Labor, 885 F.3d 360 (5th Cir. 2018).

[4] *Id.* (Stewart, Chief Judge, dissenting) (noting the Fifth Circuit majority's unwillingness to engage with "the relevant context of time and evolving marketplace events" when evaluating the Department of Labor's rule).

[5] 15 U.S.C. §80b-11(g) ("The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retain customers . . . shall be to act in the best interest of the customer *without regard to the financial or other interest of the broker*" (emphasis added)).

[6] Department of Labor, Regulating Advice Markets: Definition of the Term 'Fiduciary": Regulatory Impact Analysis for Final Rule and Exemptions (April 2016), at 34 ("[T]he suitability standard often permits brokers to recommend investments that favor their own financial interests or the financial interests of their firm in preference to better investments that favor the customers' interests.").

[7] Securities and Exchange Commission, Proposing Release, Proposed Rule Establishing a Standard of Conduct for Broker-Dealers When Making a Recommendation of Any Securities Transaction, Release No. 34-____, (April 18, 2018), 68 [hereinafter Regulation Best Interest Proposing Release].

[8] *Id.* at 183.

[9] Particularly important is the proposal's clear language that the prohibition on the use of particular titles is in addition to a prohibition on brokers engaging in misleading advertising. *See* Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles Proposing Release, at 183.

[10] Robert J. Jackson, Jr., *Cost-Benefit Analysis and the Courts*, 78 Law & Contemp. Probs. 55 (2015).

[11] *See* Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers (January 2011).

[12] The literature that *is* reviewed in our economic analysis consists of a series of decades-old (though seminal) theoretical articles about the potential conflicts that arise in agency relationships. I'm an enormous fan of Ronald Coase, but a citation to his fifty-year-old article does not reflect a reasonable review of the relevant literature on broker-dealer duties to American investors. *See* Regulation Best Interest Proposing Release at 219 & n.378 (citing Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & Econ. 1 (1960)).

[13] I am aware, of course, that the Department of Labor's economic analysis has been the subject of criticism, including from the Commission's former Chief Economist. *See* Craig M. Lewis, *The Flawed Cost-Benefit Analysis Underlying the Department of Labor's Fiduciary Rule* (August 2017) (white paper written during Dr. Lewis's tenure as Senior Advisor at Patomak Global Partners). I am disinclined to disregard years of empirical analysis of consumer behavior and financial markets—much of which was published in the top academic journals in the Nation—on the basis of a seventeen-page white paper. Whatever one's view on that question, however, all should agree that our engagement with the Department of Labor's analysis should extend beyond a single dismissive and unpersuasive footnote. The law, to say nothing of our commitment to American investors regarding a rulemaking of this magnitude, demands far more.

[14] *See, e.g.*, Department of Labor, *supra* note 6, at 150-54 (citing, *inter alia*, Diane Del Guercio & Jonathan Reuter, *Mutual Fund Performance and the Incentive to Generate Alpha,* 69 J. Fin. 1673 (2014); Susan Christoffersen et al., *What Do Consumers' Fund Flows Maximize? Evidence from their Broker's Incentives*, 68 J. Fin. 201 (2013); Daniel Bergstresser et al., *Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry*, 22 Rev. Fin. Stud. 4129 (2009); Matthew Morey, *Should You Carry the Load? A Comprehensive of Load and Noload Mutual Fund Out-of-Sample Performance*, 27 J. Bank. & Fin. 1245 (2003)).

[15] *See* Regulation Best Interest Proposing Release at 266 & n.460. What's worse, as footnotes go, this one is utterly unpersuasive; the stated reason for disregarding economic analysis based upon dozens of peer-reviewed articles is that Regulation Best Interest is "different in scope" from the Department of Labor's rule. That is, of course, a reason to make adjustments to the Department's assumptions. It is not a reason completely to disregard that work, especially in the total absence of any other empirical estimates of the benefits of Regulation Best Interest throughout our economic analysis.

[16] *See, e.g.*, Regulation Best Interest Proposing Release at 266 ("The Commission is unable to quantify the magnitude of the benefits that retail customers could receive as a result of the new obligations"); *id.* at 278 (same, as to certain costs); *id.* at 301 (same, as to other costs); *id.* at 308 (same, as to still other costs).

[17] I especially urge commenters will provide the kind of hard evidence that will allow us to conduct the serious economic analysis that will be required to justify a rule of this scale and scope. *Compare* Commissioner Robert J. Jackson, U.S. Securities and Exchange Commission, Statement on Proposed Amendments to Public Reporting of Fund Liquidity Information (March 14, 2018) (distinguishing "letters from industry groups" from the empirical evidence that should form the basis of our regulatory judgments).

[18] *See, e.g.*, Alana Semuels, *This is What Life Without Retirement Savings Looks Like*, The Atlantic (Feb. 22, 2018).

TAB 12

Public Statement

Statement at the Open Meeting on Standards of Conduct for Investment Professionals

Commissioner Hester M. Peirce

April 18, 2018

I want to begin by thanking the Chairman for making this rulemaking a priority for the Commission. There has been tremendous confusion in recent years among retail investors about what legal standards apply and what type of financial professional they are engaging to provide them with investment advice. To get us to today's recommended proposals, many hours and much hard work were expended by staff in the Divisions of Trading and Markets, Investment Management, and Economic and Risk Analysis, together with the General Counsel's Office, the Office of Investor Education and Advocacy, the Chairman's staff, and many others throughout the Agency. Thank you all for your efforts.

As you will hear from my comments, I share some of my colleagues' concerns, including concerns about the rule's lack of clarity. Nevertheless, I do not agree with the assessment that the emperor has no clothes. If this proposal is adopted, the emperor will be wearing more clothes than he is wearing now. It is not clear whether it is a cape or sweater that he will be adding to his wardrobe, but he will be wearing an extra layer. Getting comments from retail investors, other regulators, and the professionals who deal with retail investors every day will help us to clarify the rule text. I do not agree that the economic analysis should be modelled on the analysis that the Department of Labor conducted for its rule. It can be tempting to try to assign precise numbers to costs and benefits, but underlying such precision are often assumptions. When those assumptions are flawed, so too are the numbers they produce.

I support putting these proposals out for comment. My hope is that today's proposals are a step along the way to the ultimate adoption of a clear standard for broker-dealers to abide by when providing investment advice to retail investors; clear, simple, and informative disclosure for retail investors choosing a financial professional; and clarity as to investment advisers' duties to clients. Done right, this package will result in clear guideposts for investors, regulators, and providers of financial services.

I hope that whatever is ultimately adopted preserves investor choice, so that retail customers still have the option to choose how and where to seek investment advice.

Today's proposals, I anticipate, will generate substantial feedback as to what the proposals get right and, more importantly for producing a strong set of final rules, where they miss the mark. To that end, each release contains many questions. I have a number of concerns, on which I particularly welcome feedback.

Anyone who endeavors to read all the releases will be daunted by their collective heft. SEC printers are all crying out for new toner cartridges, and lugging our best interest binders around the halls has become a substitute for going to the SEC gym. While the length of these releases provides lots of fodder for jokes, it's a serious matter. It makes it difficult for readers to understand what we are proposing, and thus harder for us to elicit comment on key points. In a proposal asking our registrants to be clear with their customers, we ought ourselves to provide clear standards and requirements for our registrants.

Disclosure should be the centerpiece of our reforms. We are proposing today a new customer or client relationship summary. The most valuable aspect of the relationship summary may be the list of questions included at the end, which may help to inspire a healthy skepticism and inquisitiveness in investors. The rest of the summary may not be as useful. While I favor requiring firms to spell out clearly the services they are offering and the fees they charge, I am concerned that the approach we are taking will simply mean a few more pages of unread paper landing in investor trash cans. Specifically, I am concerned that:

- First, although we make room for electronic delivery and ask questions about other modes of delivery, the proposed disclosure falls back on an unimaginative paper-based default; we are mandating a standardized 4-page summary with specific instructions about font size, placement in the stack of papers handed to investors, and filing requirements. If instead we encouraged firms to be creative in their use of videos, interactive computer-based disclosure, mobile apps, and so forth, investors would be more likely to take in and think about the information we want them to understand. Allowing more creativity would complicate our oversight efforts, but this drawback seems outweighed by the potential benefits. I appreciate the staff working with me to make the proposal more open to innovative methods, and I hope commenters will give us more ideas.
- Second, the prescribed language and model forms in today's package are not, in my opinion, a model of clarity. That said, my opinion matters less than the opinions of investors who will use the form. I look forward to seeing the results of our own and others' investor testing of the forms.
- Third, the relationship summary, along with new requirements in Regulation BI, will be additive disclosure. Disclosure overload is also an issue for investors—a problem today's proposed changes only exacerbate.
- Fourth, the relationship summary mandate asks firms to make disclosures about services they offer, but also requires them to disclose information about services they do *not* offer. Directing firms to talk about what other firms do is unusual and not likely to produce accurate, meaningful information for investors.
- Fifth, the relationship summary would use ongoing monitoring as the main line of demarcation between advisers and broker-dealers. Broker-dealers can disclose that they offer monitoring, but they must describe how often they monitor. The implication that advisers monitor

continuously, while broker-dealers, if they monitor at all, do so only periodically, may not reflect the reality for either advisers or brokers. Moreover, the term monitor is commonly understood to mean “to watch, keep track of, or check . . . .”[1] The apparent deviation from this standard understanding of the word—in the release’s use “monitoring” is not necessarily an ongoing activity—could generate further confusion.

- Sixth, one of the most valuable things for investors to know is how much the services and products in which they invest will cost them. Such information is very hard to provide with precision in advance, but the proposed summary does not offer much concrete information for investors to grab on to as they seek to get a sense of what they might pay. I look forward to commenters’ insights on what we can do at the beginning of the customer relationship and periodically to provide investors more of an idea of how much they are paying for the products and services they are buying. Although providing this type of individualized information for investors might be difficult, technological advances may make it easier for firms to provide more meaningful, personalized fee information to investors. Again, a more interactive approach might help in this regard.

Regulation Best Interest responds to calls—dating back years—for a revamped broker-dealer conduct standard. Although “suitability” has become something of an unspeakable word, it is a standard that has served investors well. There have nevertheless been loud, persistent calls for a more robust standard. I am not necessarily averse to creating such a standard, but we must be clear about what we are doing and about how broker-dealers can comply with it. The proposal lacks clarity on both issues, and I am concerned that, if it is not refined through the public comment process, it will be unworkable as a final standard.

- First, the rule text is not sufficiently clear about what the Best Interest standard is and how it relates to existing broker obligations. It would be better to acknowledge that we are imposing a suitability-plus standard and explain what we mean by the “plus.” The release’s gloss on the rule text is inadequate; the release suggests both that the new standard may be consistent with interpretations of current standards that apply to broker-dealers and that it is different in some way from the existing obligations on broker-dealers. I welcome suggestions on how we can clarify the rule text so that the contours of the standard are evident to investors, broker-dealers, and regulators.
- Second, if we do not get the conduct standard for broker-dealers right, we risk exacerbating a long-term decline in the number of broker-dealers. The investment adviser regime—with its lack of a self-regulatory organization, its flexible standards that can be tailored through disclosure, its relative lack of rules, and its potentially lucrative asset-based fees—has inspired some financial professionals to switch hats. As the Chairman has underscored, we hope to maintain choice for investors. But to the extent that lack of clarity in the proposed standard creates compliance uncertainty for broker-dealers, I fear that it may intensify the decline of the broker-dealer model. I encourage commenters to address ways we can modify the proposal to avoid pushing more firms to abandon the broker-dealer model that has served many investors so well for so many decades.
- Third, the term Best Interest sets an impossible standard. Determining whether a particular recommendation is in a customer’s best interest is a value-laden judgment that could be interpreted to require the broker-dealer to see into the future and to evaluate possible states of the world in light of the broker-dealer’s notion of the customer’s best interest gleaned from the

customer's investor profile. It also requires the broker-dealer, and its registered reps, to understand the full range of available products. Clearly, we cannot require either of those things, but planning for what the Commission will demand through examinations and enforcement actions could be a very expensive exercise for many broker-dealers. On one hand, I am concerned that some may determine to limit their exposure by, for example, limiting their range of investment products to a number that their most junior registered reps can understand to our satisfaction. On the other, I worry that firms will feel driven by the rule to expand their product offerings to include products they don't understand.

- Finally, I take issue with how the term "Best Interest" will be used. People have been invoking "Best Interest" around Washington over the last decade as if it were an incantation that could cure all that is wrong in the retail investor space. Yet after so many years, I still have not found anybody—whether in industry or otherwise—who can explain to me what it means. I fear, however, that "Best Interest" will continue to be used, only now as a Commission-approved incantation, a spell that, much like the term "fiduciary," charms investors into not asking questions, precisely because it is devoid of concrete content. After all, if the government, through the name of the regulation, is telling investors that brokers are acting in their best interest, which each investor is likely to interpret differently, what need have investors to press for more details?

This rulemaking package includes a proposed interpretation intended to provide some definition to the fiduciary standard applicable to investment advisers. Collecting in one place the pieces of this standard is a valuable undertaking. It will be useful to investors, investment advisers, and the Commission. I look forward to hearing feedback about whether we have appropriately captured the fiduciary standard as it is currently understood. I have several concerns about this portion of the package:

- First, the proposed interpretation makes new law. For example, it states that an adviser and its clients can shape their relationship through disclosure and informed consent. The informed consent requirement is new; the only Commission basis is a mention in an instruction to Form ADV.
- In addition to laying out the contours of the federal fiduciary duty for investment advisers, the proposal includes a set of potential new obligations on investment advisers, including federal licensing and continuing education, net capital requirements, and fidelity bonds. Not only do I believe we lack authority for these requirements, but they would represent a paradigm shift in the way we regulate investment advisers. The adviser regime is largely a principles-based one, not one in which the SEC signs off on the quality of the advice provided or the advisers providing it. Custody rules already exist to protect investor funds. This portion of the proposal is a distraction from today's focus on establishing and articulating standards for broker-dealers and investment advisers. I do not favor steps that would force investment advisers to look more like broker-dealers any more than I favor forcing broker-dealers into the adviser mold.

A final global concern is that these proposals will change for the worse the way investors and their financial professionals interact. We do not want to turn an investor's visit to her investment adviser or broker-dealer into a sterile compliance exercise that focuses on delivering a pile of documents and checking off a list of required disclosures rather than engaging with the investor's needs. An interaction scripted to satisfy regulators risks leaving investors entirely unsatisfied. First-time investors who would benefit from saving even fifty or a hundred dollars a month may be intimidated by basic terms like "stocks" and "bonds" and "mutual funds." What many of these investors need is simply a frank, earnest, non-technical conversation with a professional who can persuade them to start putting away a bit of money. I worry that what this package may provide instead is just another excuse, in the form of more disclosures involving even more challenging terms like “fiduciary” and “best interest,” for them to avoid thinking about their finances at all.

These proposals are an extensive undertaking, so my list of concerns is also extensive. Notwithstanding these concerns, however, I believe that the proposals represent an excellent first step down the path of reform: They grapple seriously with possible solutions to investor confusion; they attempt to clarify an often-amorphously defined fiduciary standard for investment advisers; and they attempt to clarify, codify, and confirm that broker-dealers need to make recommendations to retail customers that are not driven primarily by the potential fees they can generate. I look forward to hearing from commenters about these and other issues.

I want to close by again commending the staff for their unflagging commitment to this difficult, but important project. Your willingness to work with us through many difficult questions made the proposals better. I know there is still a lot of hard work ahead, but I am confident that—after a bit of rest—you will all enthusiastically take on the next phase of this important rulemaking.

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[1] Merriam Webster, online dictionary, https://www.merriam-webster.com/dictionary/monitor?utm_campaign=sd&utm_medium=serp&utm_source=jsonld .

TAB 13

Regulatory Notice 18-13

Quantitative Suitability

FINRA Requests Comment on Proposed Amendments to the Quantitative Suitability Obligation Under FINRA Rule 2111

Comment Period Expires: June 19, 2018

Summary

FINRA seeks comment on proposed rule amendments that would revise the quantitative suitability obligation under FINRA Rule 2111 (Suitability) to more effectively address instances of excessive trading in customers' accounts. The proposed rule amendments would remove the element of control that currently must be proved to demonstrate a violation, but would not change the obligations to prove that the transactions were recommended and that the level of trading was excessive and unsuitable in light of the customer's investment profile.

The proposed rule text is available in Attachment A.

Questions regarding this *Notice* should be directed to:

- James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270; or
- Meredith Cordisco, Associate General Counsel, OGC, at (202) 728-8018.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by June 19, 2018.

Comments must be submitted through one of the following methods:

- Emailing comments to *pubcom@finra.org*; or
- Mailing comments in hard copy to:

  Jennifer Piorko Mitchell
  Office of the Corporate Secretary
  FINRA
  1735 K Street, NW
  Washington, DC 20006-1506

FINRA

Financial Industry Regulatory Authority

April 20, 2018

Notice Type

- Request for Comment

Suggested Routing

- Compliance
- Legal
- Operations
- Registered Representatives
- Senior Management

Key Topics

- Excessive Trading
- Quantitative Suitability
- Suitability

Referenced Rules & Notices

- FINRA Rule 2111
- Notice to Members 01-23
- Regulatory Notice 11-02
- Regulatory Notice 11-25
- Regulatory Notice 12-25

To help FINRA process comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, FINRA will post comments as they are received.[1]

Before becoming effective, the proposed rule change must be filed with the Securities and Exchange Commission (SEC) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA or Exchange Act).[2]

Background & Discussion

In 2010, when FINRA amended its longstanding suitability rule, it codified the line of cases on excessive trading (sometimes referred to as "churning") as the rule's quantitative suitability obligation.[3] Consistent with the case law, FINRA's quantitative suitability obligation requires a broker who has control over a customer's account to have a reasonable basis for believing that a series of transactions the broker recommends is not excessive and unsuitable for the customer, even if the individual transactions are suitable when viewed in isolation. However, if a broker does not control a customer's account, the quantitative suitability obligation does not apply when the broker recommends a series of transactions, even if that series of transactions is excessive and unsuitable for the customer. FINRA has reconsidered the appropriateness of the control element in light of its experience with the rule, the other requirements of the rule and, more recently, the SEC's proposed Regulation Best Interest (Regulation BI).[4] FINRA seeks comment on its proposal to amend Supplementary Material .05(c) of Rule 2111 to remove the control element from the quantitative suitability obligation.

A. Actual or De Facto Control Under Quantitative Suitability

Under the quantitative suitability obligation, control can be actual or de facto. In general, actual control exists when a broker has formal discretionary authority over a customer's account.[5] A showing of de facto control over a customer's account depends on whether the customer routinely follows the broker's advice because the customer is unable to evaluate the broker's recommendations and exercise independent judgment.[6] In practice, however, these assessments can be difficult to make and they place a heavy and unnecessary burden on customers by, in effect, asking them to admit that they lack sophistication or the ability to evaluate a broker's recommendations. This is true even where it is otherwise clear that the broker recommended the transactions and that they were excessive and unsuitable. FINRA is concerned that the control element serves as an impediment to investor protection and an unwarranted defense to unscrupulous brokers.

B. Proposed Amendments

The proposed amendments would remove the phrase "who has actual or de facto control over a customer account" from the quantitative suitability obligation under Supplementary Material .05(c) of Rule 2111. The original basis for requiring the control element is unnecessary under the suitability rule. The inclusion of the control element has its historic roots, in part, in the perceived need to ensure that the culpability for excessive trading rested with the party responsible for initiating the transactions in actions brought pursuant to the antifraud provisions of the federal securities laws.[7] That concern is not present under FINRA's suitability rule. Because FINRA must show that the broker *recommended* the transactions in order to prove a Rule 2111 violation, culpability for excessive trading will still rest with the appropriate party even absent the control element.[8] Moreover, the existence of the control element may impede investor protection by acting as an unintended shield for unscrupulous brokers engaged in excessive trading. Indeed, as the SEC noted in proposing Regulation BI, "the fact that a customer may have *some* knowledge of financial markets or *some* 'control' should not absolve the broker-dealer of its ultimate responsibility to have a reasonable basis for any recommendations that it makes."[9]

Finally, the proposed rule would continue to require FINRA to prove that the series of recommended transactions was excessive and unsuitable, and the proposed amendments would not affect the extensive case law concerning whether trading activity is excessive. Whether trading activity in a customer's account is excessive would still depend on the facts and circumstances of a particular case and would continue to be assessed in light of the customer's investment profile.[10] Although no single test defines excessive activity, factors such as turnover rate,[11] cost-to-equity ratio[12] or the use of in-and-out trading[13] may provide a basis for a finding of excessive trading.[14] A turnover rate of six or a cost-to-equity ratio above 20 percent generally is indicative of excessive trading.[15] However, lower ratios have supported findings of excessive trading for customers with very conservative investment objectives,[16] while somewhat higher ratios have not supported findings of excessive trading for some customers with highly speculative investment objectives and the financial resources to withstand potential losses.[17] In addition to these ratios, a pattern of in-and-out trading in relatively short periods of time is a "hallmark" of excessive trading, which, by itself, can provide a basis for finding excessive trading.[18]

Economic Impact Assessment

A. Economic Baseline

The economic impact of the proposed rule is dependent on the effects of removing the control element from the quantitative suitability obligation. The control element in the current rule makes it difficult to enforce the quantitative suitability obligation, even where the excessiveness of the trading and the broker's responsibility for the recommendations are clear. As a result, brokers may be able to recommend excessive levels of trading to their customers but avoid disciplinary actions for violating the quantitative suitability obligation because of the difficulty in assessing and proving de facto control over their customers' accounts.

B. Economic Impact

The proposed amendment to Rule 2111 would promote investor protection. Removing the control element from the quantitative suitability obligation would likely increase FINRA's ability to hold brokers responsible for recommendations resulting in excessive trading and serve as a deterrent to possible future misconduct.

As a general proposition, a potential impact of reducing the threshold for establishing a violation of any rule may be that it increases the probability of establishing a violation in the presence of less evidence. However, FINRA does not believe the removal of the control element would lead to disciplinary actions against brokers for excessive trading when the brokers are not responsible for initiating the transactions. In the absence of the control element, FINRA's suitability rule will continue to require FINRA to prove that the broker recommended the transactions and that the transactions were excessive and unsuitable in light of the customer's investment profile. These elements ensure that the culpability for excessive trading continues to rest with the appropriate party. The control element is an unnecessary layer of proof regarding the identity of the responsible party (*i.e.*, the party initiating the transactions) and does not in any way touch on the proof needed to establish the underlying, substantive misconduct (*i.e.*, the excessive trading activity inconsistent with the customer's investment profile).

FINRA believes, moreover, that the proposed change would impose minimal, if any, additional compliance burdens on members because FINRA understands that firms already routinely perform compliance reviews for excessive trading activity without consideration of whether a broker controls the account. The primary cost may be that member firms would need to update written supervisory procedures.

Request for Comment

FINRA requests comment on all aspects of the proposal. FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible. FINRA specifically requests comment concerning the following questions:

1. How does your firm currently monitor for potentially excessive trading in customer accounts? Does your firm consider whether brokers have de facto control over customers' accounts when monitoring for potential excessive trading? If so, how does your firm conduct such monitoring?
2. The proposal would remove the element of control from the quantitative suitability obligation. Would the requirement to prove that the transactions were *recommended* continue to ensure that the culpability for excessive trading rests with the appropriate party?
3. Are there alternative ways to address excessive trading that should be considered? If so, what are the alternative approaches that FINRA should consider?
4. Are there any material economic impacts, including costs and benefits, to investors, brokers and firms that could result from implementation of the proposed amendments?

Endnotes

1. Persons submitting comments are cautioned that FINRA does not redact or edit personal identifying information, such as names or email addresses, from comment submissions. Persons should submit only information that they wish to make publicly available. *See Notice to Members 03-73* (Online Availability of Comments) (November 2003) for more information.

2. *See* SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes take effect upon filing with the SEC. *See* SEA Section 19(b)(3) and SEA Rule 19b-4.

3. *See Regulatory Notice 12-25*, at 14 (May 2012). Although the terms "churning" and "excessive trading" are often used interchangeably, churning requires scienter in order to prove a fraud, whereas "excessive trading," now known as quantitative suitability, does not. *See David A. Roche*, 53 S.E.C. 16, 22 (1997).

4. On April 18, 2018, the SEC proposed Regulation Best Interest, which would create a new rule under the Exchange Act and establish a "best interest" standard of conduct for broker-dealers and associated persons when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer. *See* Regulation Best Interest, Exchange Act Release No. 83062 (Apr. 18, 2018) (Regulation BI Proposing Release). One element of the multi-pronged approach proposed by the SEC would incorporate and go beyond existing suitability obligations under the federal securities laws and FINRA Rule 2111. *Id.* at 10. In incorporating a prohibition on excessive trading, the SEC expressly excluded the "control" element currently present in FINRA's quantitative suitability rule, noting that the SEC proposed requirement would apply irrespective of whether a broker-dealer exercises actual or de facto control over a customer's account. *Id.* at 150. As a result, in order to satisfy the best interest standard, the SEC proposal would require that a broker-dealer or associated person exercise reasonable diligence, care, skill, and prudence to, among other things, 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. *Id.* at 133. The SEC's decision to eliminate the "control" element from its proposal is consistent with FINRA's proposed amendment to the quantitative suitability obligation described herein. FINRA notes, as well, that it will consider the potential impact of Regulation BI, if adopted, on FINRA's suitability rule more generally.

5. *See Peter C. Bucchieri*, 52 S.E.C. 800, 805 n.11 (1996). Where a broker exercises discretion over an account or engages in unauthorized trading, he or she is viewed as having implicitly recommended the transactions. *See Dep't of Enforcement v. Murphy*, No. 2005003610701, 2011 FINRA Discip. LEXIS 42, *42 n.33 (NAC Oct. 20, 2011) ("Any violation of the suitability rule also requires proof that there was a 'recommendation.' When a broker exercises discretion to make trades or engages in unauthorized trading, . . . such trades are considered to be implicitly recommended for purposes of the suitability rule.").

6. *See Harry Gliksman*, 54 S.E.C. 471, 475 (1999).

7. *See E.H. Rollins & Sons, Inc.*, 18 S.E.C. 347, 380 (1945) (stating that a broker "cannot be held guilty of overtrading in an account where transactions are initiated by the customer" and that, with regard to excessive trading liability under the antifraud provisions of the Exchange Act, the question is whether the broker occupied "such a status with respect to the customer that he may be held responsible for excessive trading in such customer's account").

8. Although FINRA has not defined "recommendation," FINRA has provided several guiding principles through past *Notices* that are relevant to the analysis. *See*, *e.g.*, *Regulatory Notice 12-25; Regulatory Notice 11-02* (January 2011); *Regulatory Notice 01-23* (April 2001). These guiding principles remain applicable for the determination of a recommendation under the proposed amendments to the quantitative suitability obligation.

9. Regulation BI Proposing Release, *supra* note 4, at 155.

10. *See Richard G. Cody*, Exchange Act Release No. 64565, 2011 SEC LEXIS 1862, at *40-41 (May 27, 2011), *aff'd sub. nom.*, *Cody v. SEC*, 693 F.3d 251 (1st Cir. 2012).

11. Turnover rate is calculated by "dividing the aggregate amount of purchases in an account by the average monthly investment. The average monthly investment is the cumulative total of the net investment in the account at the end of each month, exclusive of loans, divided by the number of months under consideration." *Rafael Pinchas*, 54 S.E.C. 331, 339-40 n.14 (1999).

12. The cost-to-equity ratio represents "the percentage of return on the customer's average net equity needed to pay broker-dealer commissions and other expenses." *Id.* at 340.

13. In-and-out trading refers to the "sale of all or part of a customer's portfolio, with the money reinvested in other securities, followed by the sale of the newly acquired securities." *Costello v. Oppenheimer & Co.*, 711 F.2d 1361, 1369 n.9 (7th Cir. 1983).

14. *See Dep't of Enforcement v. Medeck*, No. E9B2003033701, 2009 FINRA Discip. LEXIS 7, *34 (NAC July 30, 2009).

15. *See Howard*, 55 S.E.C. at 1100-01 ("While there is no definitive turnover rate or cost-to-equity ratio that establishes excessive trading, a turnover rate of 6 or a cost-to-equity ratio in excess of 20% generally indicates that excessive trading has occurred."); *Pinchas*, 54 S.E.C. at 340 (recognizing that "a cost-to-equity ratio in excess of 20% indicates excessive trading"); *Mihara v. Dean Witter & Co.*, 619 F.2d 814, 821 (9th Cir. 1980) (recognizing that "an annual turnover rate of six reflects excessive trading"); *Arceneaux v. Merrill Lynch, Pierce, Fenner & Smith*, 767 F.2d 1498, 1502 (11th Cir. 1985) (same); *Craighead v. E.F. Hutton & Co.*, 899 F.2d 485, 490 (6th Cir. 1990) (same).

16. Turnover rates between three and six may trigger liability for excessive trading, depending on the facts and circumstances. *See Cody*, 2011 SEC LEXIS 1862, at *51 (finding turnover rate of 3.21 to be excessive given customers' conservative investment objectives); *Dep't of Enforcement v. Stein*, No. C07000003, 2001 NASD Discip. LEXIS 38, at *17 (NAC Dec. 3, 2001) ("Turnover rates between three and five have triggered liability for excessive trading"), *aff'd sub. nom.*, *Jack H. Stein*, 56 S.E.C. 108 (2003). Even turnover rates below three may provide a basis for finding excessive trading. *See Sandra K. Simpson*, 55 S.E.C. 766, 794 (2002) (finding turnover rate as low as 2.10 provided support that trading was excessive for customers with conservative investment objectives); *Jenny v. Shearson, Hammill & Co.*, 1978 U.S. Dist. LEXIS 15077, at *6 (S.D.N.Y. Oct. 6, 1978) (refusing to hold, as a matter of law, that a turnover rate of 1.84 cannot be excessive for any account). In addition, cost-to-equity ratios as low as 8.7 percent have been considered indicative of excessive trading and ratios above 12 percent generally are viewed as strong evidence of excessive trading. *See Cody*, 2011 SEC LEXIS 1862, at *49 and *55 (finding cost-to-equity ratio of 8.7 percent excessive); *Thomas F. Bandyk*, Exchange Act Release No. 35415, 1995 SEC LEXIS 481, at *2–3 (Feb. 24, 1995) (finding cost-to-equity ratios ranging between 12.1 percent and 18 percent excessive).

17. *See DBCC v. Zandford*, No. WA-530, 1989 NASD Discip. LEXIS 39, *21 (DBCC June 7, 1989) (finding that a turnover rate of 9.6 was not excessive under the unique facts of the case, including that the customers had highly speculative investment objectives and financial resources such that they could withstand potential losses).

18. *See Howard*, 55 S.E.C. at 1100-01; *Pinchas*, 54 S.E.C. at 339.

Attachment A

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

2000. DUTIES AND CONFLICTS

* * * * *

2100. TRANSACTIONS WITH CUSTOMERS

* * * * *

2110. Recommendations

* * * * *

2111. Suitability

(a) through (b) No Change.

• • • Supplementary Material: --------------

.01 through .04 No Change

.05 Components of Suitability Obligations. Rule 2111 is composed of three main obligations: reasonable-basis suitability, customer-specific suitability, and quantitative suitability.

(a) through (b) No Change.

(c) Quantitative suitability requires a member or associated person [who has actual or de facto control over a customer account] to have a reasonable basis for believing that a series of [recommended] transactions <u>the member or associated person recommended to the customer account</u>, even if suitable when viewed in isolation, are not excessive and unsuitable for the customer when taken together in light of the customer's investment profile, as delineated in Rule 2111(a). No single test defines excessive activity, but factors such as the turnover rate, the cost-equity ratio, and the use of in-and-out trading in a customer's account may provide a basis for a finding that a member or associated person has violated the quantitative suitability obligation.

.06 through .07 No Change.

TAB 14

Morgan Lewis

LAWFLASH

SEC PROPOSES STANDARDS OF CONDUCT FOR BROKER-DEALERS, INVESTMENT ADVISERS

April 20, 2018

AUTHORS AND CONTACTS

JENNIFER L. KLASS, STEVEN W. STONE, BRIAN J. BALTZ, CHRISTINE M. LOMBARDO

In a first step toward developing standards for advice to retail customers, the Securities and Exchange Commission recently proposed rules and interpretive guidance intended to enhance investor protections while preserving investment choice and access.

The Securities and Exchange Commission (SEC) voted on April 18 to propose standards for broker-dealers and investment advisers when providing recommendations and investment advice to retail customers in a three-part package that includes

- Proposed Regulation Best Interest — Standard of Conduct for Broker-Dealers
- Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation
- Form CRS Relationship Summary; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles (Note there are links to a number of related appendices and other materials available here.)

We are reviewing the text (1,000+ pages), but here are our first impressions.

WHAT HAPPENED?

- Following an open meeting, the SEC voted 4–1 to propose the package of rulemaking and guidance. Commissioner Kara Stein was the dissenting vote, and Commissioner Robert Jackson voted to move forward to begin consideration of the proposals while noting he did not support the package.
- Chairman Jay Clayton emphasized that the package is intended to close the gap between investor expectations and current law while preserving access and choice. He also sees this proposal as addressing concerns about a patchwork of standards developing for retail investment advice.

- The proposal will be subject to a comment period ending 90 days after the releases are published in the *Federal Register*.

WHAT DO WE KNOW ABOUT THE PROPOSAL SO FAR?

- What is "Regulation Best Interest"?
  - Proposed Regulation Best Interest would require broker-dealers to act in the best interest of the retail customer when they recommend a securities transaction or investment strategies involving securities, without placing the broker-dealer's or registered representative's financial or other interest ahead of the customer's interest.
    - The SEC has not proposed to define the term "recommendation," and instead would look to existing guidance from the Financial Industry Regulatory Authority (FINRA) as to when a broker-dealer communication is viewed as a recommendation, including a recommendation about a rollover, or is excluded from FINRA Rule 2111 (e.g., general financial and investment information, descriptive information about an employer-sponsored retirement or benefit plan, certain asset allocation models, and interactive investment materials).
    - "Retail Customer" would be defined as a person, or the legal representative of the person, who receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer or registered representative, and uses the recommendation primarily for personal, family, or household purposes.

  - A broker-dealer would satisfy the best interest obligation if it satisfies three obligations:
    - **Disclosure Obligation:** The broker-dealer, prior or at the time of the recommendation, "reasonably" discloses to the retail customer, in writing, the material facts about the scope and terms of its relationship with the broker-dealer and all material conflicts of interest associated with the recommendation. The disclosure obligation would build upon disclosures required by Form CRS, but provide flexibility to broker-dealers in deciding how to provide the required disclosures.
    - **Care Obligation:** The broker-dealer would be required to exercise "reasonable diligence, care, skill, and prudence" to (1) understand the potential risks and rewards of the recommendation and have a reasonable basis to believe that the recommendation could be in the "best interest" of at least some retail customers; (2) have a reasonable basis to believe that the recommendation is in the "best interest" of the retail customer to whom it is made based on the retail customer's investment profile and the potential risks and rewards associated with the recommendation; and (3) 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. The components of the care obligation are intended to incorporate and build upon existing reasonable-basis, customer-specific, and quantitative suitability obligations under the Securities Exchange Act of 1934 and FINRA Rule 2111.
    - **Conflicts of Interest Obligation:** The broker-dealer would be required to establish, maintain, and enforce written policies and procedures reasonably designed to identify and (1) at a minimum disclose, or eliminate, all material conflicts of interest associated with the recommendation; and (2) disclose and mitigate, or eliminate, material conflicts of interest arising from financial incentives associated with the recommendations. The SEC has not proposed prescriptive policies and procedures that broker-dealers must adopt, and instead has proposed to allow broker-dealers flexibility to decide on the appropriate approach.

  - Finally, the SEC asked for comment on whether it should revisit whether a broker-dealer's exercise of investment discretion should be viewed as "solely incidental" to the business of a broker-dealer.

- **What are the Form CRS and titling requirements?**
  - **Proposed Form CRS** (Customer/Client Relationship Summary) will require a maximum four-page form disclosure document for broker-dealers, investment advisers, and dual registrants when interacting with retail customers.
    - Firms would be required to describe the differences between brokerage and advisory services, including fees, conflicts, service levels, and standards of conduct, and include sample questions for investors to ask their financial professional to better understand the services offered.
    - Three sample Forms CRS are available here:
      - Broker-Dealer Mock-Up
      - Investment Adviser Mock-Up
      - Dual-Registrant Mock-Up

  - **Titling** requirements and restrictions will seek to address investor confusion about whether an investor is dealing with a broker-dealer or investment adviser and will prohibit the use of the terms "advisor" and "adviser" by someone who is not an investment adviser representative.

- **What does the Standard of Conduct for Investment Advisers consist of?**
  - This release consists of a proposed interpretation of the "federal fiduciary standard" applicable to investment advisers under Section 206(1) and (2) of the Advisers Act. The interpretation seeks to provide guidance about an investment adviser's obligations under the duties of loyalty and care. According to the proposed interpretation, those duties require the following:
    - Duty of loyalty
      - Duty to put the client's interest ahead of own interests
      - Duty not to unfairly prefer one client over another
      - Duty of full and fair disclosure

    - Duty of care
      - Obligation to provide advice that is suitable *and* in the client's best interest
      - Duty to seek best execution
      - Obligation to provide advice and monitoring over the course of the relationship

    - Firms should consider how the obligations in the proposed interpretation compare to their understanding of current requirements.

- The SEC also sought comment on whether it should impose additional obligations on investment advisers to address perceived gaps in regulation from what is required of broker-dealers, including
  - federal licensing and continuing education requirements for investment adviser representatives;
  - provision of account statements; and
  - financial responsibility requirements.

WHAT SHOULD FIRMS DO NOW?

- The SEC's decision to propose this package is a first step toward developing standards for advice to retail customers, regardless of whether they are investing through a retirement or taxable account.
- The proposal is subject to change through the notice and comment process, which closes 90 days after the releases are published in the *Federal Register*, although given the complexity of the issues raised, the SEC might be expected to extend the comment period.
- We encourage firms to review the release and consider submitting comments as they evaluate the impact on their business models.

WHAT IS MORGAN LEWIS DOING IN RESPONSE?

- We are reviewing the proposal and preparing a client alert with a more detailed assessment.
- We will prepare client briefings and presentations on the proposal and its impact, and work with clients to submit comment letters.
- We are coordinating with our interdisciplinary fiduciary practice to analyze the impact of the proposal on broker-dealers, investment advisers, and dual registrants, including across various business lines and product offerings.

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TAB 15

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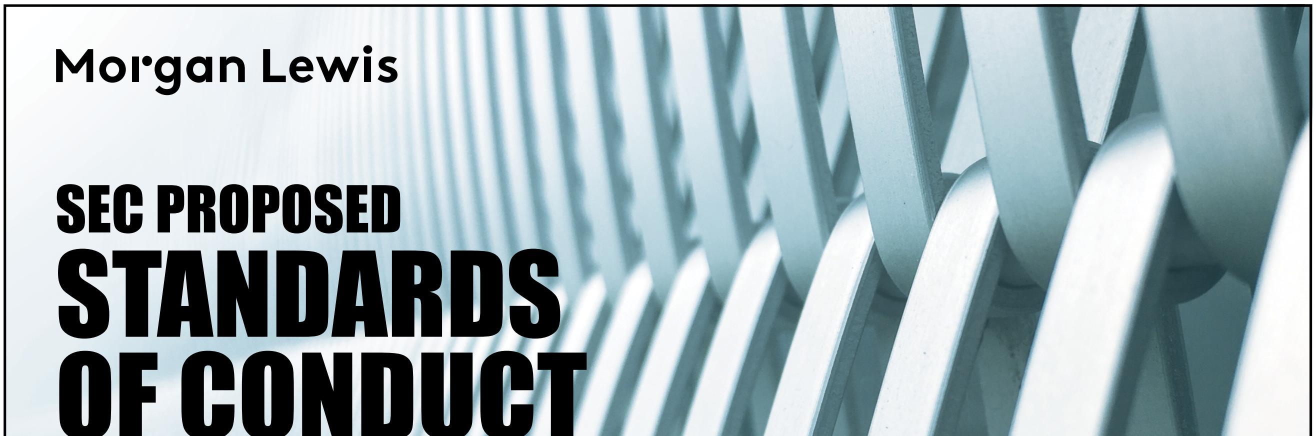


SEC PROPOSED STANDARDS OF CONDUCT FOR RETAIL ADVICE

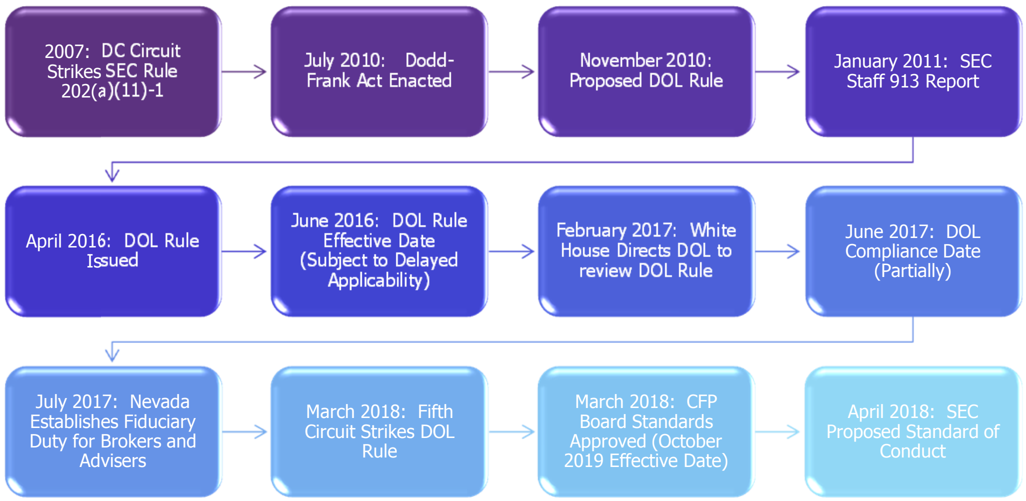
Chris Cox
Jennifer Klass
Steven Stone
Brian Baltz

May 9, 2018

Overview

- Background
- Overview of the Proposals
  - Regulation Best Interest
  - Proposed Adviser Interpretation
  - Form CRS and Use of Labels
- Impact and Next Steps

Background



Background

- DOL Rule Fifth Circuit Decision (Mar. 15, 2018)
  - Federal court of appeals vacates DOL Rule, finding it to be "unreasonable" (case brought by US Chamber of Commerce, SIFMA, and other BD/insurance groups); DOL exceeded its statutory authority (2-1 decision)
  - "Rather than infringing on SEC turf, DOL ought to have deferred to Congress's very specific Dodd-Frank delegations and conferred with and supported SEC practices to assist IRA and all other individual investors."
  - DOL had 45 days (until May 7, 2018) to appeal decision to full Fifth Circuit panel and declined to do so
  - On May 7, 2018 the DOL published its Temporary Enforcement Policy
  - Still waiting on order from Fifth Circuit vacating the rule
- SEC Chairman Clayton states that 5th Circuit decision has not changed his intent of moving forward with fiduciary rule ("the sooner, the better")
- SEC issues proposed standard of conduct for retail investors on April 18, 2018

Overview of Proposed "Package"

Regulation Best Interest	Investment Adviser Interpretation	Form CRS

• Establishes a best interest obligation for broker-dealers providing advice to retail customers
• Satisfied through
  • Disclosure Obligation
  • Care Obligation
  • Conflicts of Interest Obligation
	• Designed to clarify certain aspects of fiduciary duty under Section 206
	• Duty of Care
	  • Personalized advice that is suitable for and in the best interests of the client
	  • Best execution
	  • Ongoing advice and monitoring
	• Duty of Loyalty
	• Enhanced IA Regulation
	  • Federal Licensing and Continuing Education
	  • Account Statements
	  • Financial Responsibility
		• Four-page disclosure document
		• Delivered to retail investors before or at the time of entering into advisory contract or when retail investor first engages broker-dealer
		• Separate disclosure requirements for broker-dealers, investment advisers, and dual registrants
		• Restrictions on use of "adviser" and "advisor"
		• Prominent disclosure of status as a registered broker-dealer or investment adviser in retail communications

Regulation Best Interest

- Best Interest Obligation
  - When making a recommendation of any securities transaction or investment strategy involving securities, the broker-dealer and its registered representatives 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 registered representative ahead of the interest of the retail customer.
- "Best interest" is not defined
- Designed to enhance standard for broker-dealers, but does not make it identical to that of investment advisers
- Obligation is triggered at the time of a recommendation, and there is no ongoing obligation
- Components:
  - Disclosure Obligation
  - Care Obligation
  - Conflicts of Interest Obligation

Regulation Best Interest

- Disclosure Obligation
  - Prior to or at the time of the recommendation, the broker-dealer reasonably discloses material facts about the relationship in writing
    - Services, fees, and charges
    - Scope of relationship
    - Material conflicts of interest related to the recommendation
- Care Obligation
  - In making the recommendation, the broker-dealer exercises reasonable diligence, care, skill, and prudence
    - Reasonable-basis obligation
    - Customer-specific obligation
    - Quantitative obligation

Regulation Best Interest

- Conflicts of Interest Obligation
  - Broker-dealer establishes, maintains, and enforces written policies and procedures reasonably designed to
    - Identify and, at a minimum, disclose, or eliminate, all material conflicts of interest
    - Identify and disclose and mitigate, or eliminate, material conflicts related to financial incentives

Proposed Adviser Interpretation

- Fiduciary duty not specifically defined in the Advisers Act
- Duty of Care
  - Provide personalized advice that is suitable for and in the best interests of the client based on the client's investment profile and cost (fees and compensation)
  - Seek best execution
  - Provide advice and monitoring on an ongoing basis over course of relationship

Proposed Adviser Interpretation

- Duty of Loyalty
  - Seek to avoid conflicts of interest with clients and, at a minimum, make full and fair disclosure to its clients of all material conflicts of interest
  - Clear and detailed enough for a client to make a reasonably informed decision
  - Disclosure of a conflict alone is not always sufficient to satisfy the duty of loyalty
    - Client did not understand the nature and import of the conflict
    - Material facts concerning the conflict could not be fully and fairly disclosed
    - Disclosure does not adequately convey the material facts or the nature, magnitude, and potential effect of the conflict
  - If disclosure is insufficient, adviser should eliminate the conflict or adequately mitigate the conflict so that it can be more readily disclosed

Form CRS and Titles

- Four-page disclosure about services, fees, standard of conduct, and conflicts
- Separate disclosure requirements for broker-dealers, investment advisers, and dual registrants
- Delivery to "retail investors"
  - A prospective or existing client or customer who is a natural person (an individual), and legal representatives of such persons, regardless of net worth
  - Different from "retail customer" term used in Regulation BI
    - Receives a recommendation of any securities transaction or investment strategy involving securities
    - Uses recommendation primarily for personal, family, or household purposes
  - Disclosure focuses on an earlier stage in relationship, potentially before discussing investments

Form CRS and Titles

- Titles
  - Broker-dealers and their registered representatives may not use the term "adviser" or "advisor" when communicating with retail investors unless:
    - Broker-dealer is registered as an investment adviser
    - Registered representative is a supervised person of an investment adviser and provides advice on behalf of the adviser
- Disclosure of Registration Status
  - Prominent disclosure of registration or affiliated-person status in print or electronic communications
  - For print, in body of communication and not in a footnote
  - For electronic, in a manner reasonably calculated to draw retail investor attention

Impact and Next Steps

- Institutional Investment Advisers
- High Commission-Based Products
- Digital Investment Advisers
- Proprietary Products
- Dual Registrants

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Chris Cox advises global companies on strategic issues, corporate governance, securities regulation, and general business matters worldwide. He focuses on matters involving federal and state governments, cross-border investment, homeland security, and multistate litigation. During a 23-year Washington career, Chris was a White House counsel to President Ronald Reagan, chairman of the SEC, chairman of the Homeland Security Committee in the US House of Representatives, and the fifth-ranking elected leader in the House.

Prior to his Washington career, Chris was a partner in the corporate practice of another international law firm, where he was the head of the corporate department in Orange County and a member of the firm's national management. He also taught federal income tax as a member of the faculty at Harvard Business School.

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Jennifer Klass is a regulatory counseling lawyer with a broad background in investment management regulation. She advises clients on a wide range of investment advisory matters, including investment adviser registration and interpretive guidance, disclosure and internal controls, regulatory examinations, and enforcement actions. Her clients include major investment banks, investment advisers, broker-dealers, and the sponsors of private investment funds and mutual funds. Previously vice president and associate general counsel at Goldman, Sachs & Co., Jen’s practice focuses on the convergence of investment advisory and brokerage services.

Advertising and communications with the public, social media, and fiduciary duty and disclosure are among the securities regulatory areas in which Jen counsels clients. She also advises them on investment adviser registration, internal controls, compliance policies and procedures, separately managed (or wrap fee) programs, regulatory examinations and enforcement actions, interpretive guidance, and no-action requests.

While at Goldman, Sachs, Jen counseled its private wealth management and asset management businesses. She was also previously an associate at Morgan Lewis.

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Steven W. Stone is a securities lawyer who counsels clients on regulations governing broker-dealers, investment advisers and bank fiduciaries, and pooled investment vehicles. Head of the firm's financial institutions practice, Steve counsels most of the largest and most prominent US broker-dealers, investment banks, investment advisers, and mutual fund organizations. He regularly represents clients before the SEC, both in seeking regulatory relief and assisting clients in enforcement or examination matters.

Steve advises major US broker-dealers in the private wealth and private client businesses that offer investment advice and brokerage services to high-net-worth clients, as well as broker-dealers serving self-directing clients. He also works as counsel on various matters to the Securities Industry and Financial Markets Association's (SIFMA's) private client committee and represents most of the best-known US broker-dealers in this area. He also advises broker-dealers and investment advisers in the managed account or wrap fee area, and serves as counsel to the Money Management Institute, the principal trade association focused on managed accounts. Steve also counsels various institutional investment advisers and banks on investment management issues, including conflicts, trading, disclosure, advertising, distribution, and other ongoing regulatory compliance matters.

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Brian J. Baltz focuses his practice on the regulation of investment advisers, broker-dealers, and bank fiduciaries. Brian advises clients offering investment advice and brokerage services through their private wealth and private client businesses on issues arising under regulation by the SEC, Financial Industry Regulatory Authority (FINRA), and Office of the Comptroller of the Currency (OCC). Brian advises investment advisers, broker-dealers, and banks on investment management issues, including conflicts, disclosure, trading, wrap fee programs, soft dollar arrangements, advertising, and other ongoing regulatory compliance matters.

Before joining Morgan Lewis, Brian held multiple positions in the Division of Trading and Markets of the SEC, including special counsel in the Office of Chief Counsel and special counsel in the SEC's Office of Market Supervision. While in the Office of Chief Counsel, he was part of the team responsible for drafting a proposed rule to establish a uniform standard of conduct for broker-dealers and investment advisers. Prior to his work at the SEC, Brian was public policy counsel to a financial services industry trade association based in Washington, DC, where he worked on legislative and regulatory issues impacting broker-dealers and investment advisers, including the Dodd-Frank Wall Street Reform and Consumer Protection Act.

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TAB 16

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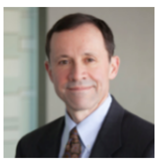

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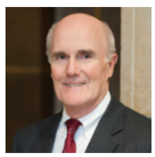

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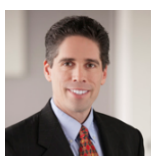

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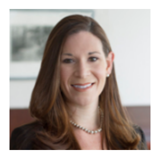

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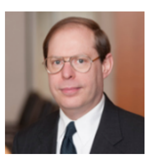

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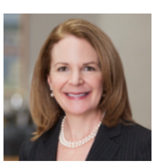

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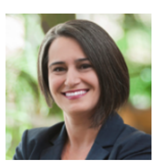

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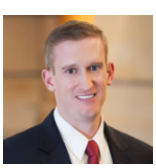

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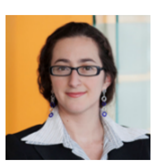

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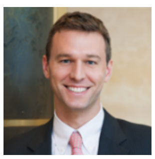

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